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RECENT STUDIES OF THE AFDC QUALITY CONTROL SYSTEM AND THE NEED FOR REFORM

HEARING

BEFORE THE

SUBCOMMITTEE ON PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

SECOND SESSION

APRIL 12, 1988

Serial 100–67

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE
87-153 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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RECENT STUDIES OF THE AFDC QUALITY CONTROL SYSTEM AND THE NEED FOR REFORM

TUESDAY, APRIL 12, 1988

House of Representatives,
Committee on Ways and Means,
Subcommittee on Public Assistance
and Unemployment Compensation,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room B-318, Rayburn House Office Building, Hon. Thomas J. Downey (acting chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
THURSDAY, MARCH 24, 1988

PR #13
SUBCOMMITTEE ON PUBLIC ASSISTANCE
AND UNEMPLOYMENT COMPENSATION
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
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THE HONORABLE THOMAS J. DOWNEY (D., N.Y.), ACTING CHAIRMAN, SUBCOMMITTEE ON PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING ON RECENT STUDIES OF THE AFDC QUALITY CONTROL SYSTEM AND THE NEED FOR REFORM

The Honorable Thomas J. Downey, Acting Chairman, Subcommittee on Public Assistance and Unemployment Compensation, Committee on Ways and Means, U.S. House of Representatives today announced a hearing on recent studies of the Aid to Families with Dependent Children (AFDC) quality control system and the need for reform. The hearing will be held on Tuesday, April 12, 1988, beginning at 10:00 a.m. in room B-318 Rayburn House Office Building.

In announcing the hearing, Chairman Downey said, "Two years ago we asked the National Academy of Sciences and the Department of Health and Human Services to study the AFDC quality control system and recommend improvements. At this hearing we will review the recently completed studies and consider the need for reform."

The Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272) established a moratorium on the collection of AFDC fiscal sanctions. The moratorium currently prohibits the Department of Health and Human Services from reducing AFDC payments to States with high erroneous payment rates. This moratorium expires on July 1, 1988. In addition to the moratorium, P.L. 99-272 requires that the Department and the National Academy of Sciences conduct studies of the AFDC quality control system. These studies must examine how best to operate the quality control system to provide: (1) program managers with information that can improve the quality of administration; and (2) reasonable data on which to withhold Federal funding to States with excessive levels of erroneous payments.

The Subcommittee will hear testimony from invited witnesses only. Witnesses at the hearing will include members of the panel which developed the National Academy of Sciences study and representatives of the Department of Health and Human Services.

WRITTEN STATEMENTS FOR THE RECORD:

Any interested person or organization may file a written statement for inclusion in the printed record. Persons submitting written statements for the printed record of the hearing should submit at least six (6) copies by the close of business, Wednesday, April 27, 1988, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

Acting Chairman **Downey**. The Subcommittee on Public Assistance and Unemployment Compensation will come to order.

The subject of today's hearings is AFDC quality control, an issue that Congress has struggled with for the last 10 years. The AFDC quality control system currently serves two purposes. First, and most importantly, it provides program managers at the State and local level with information about the accuracy of their eligibility decisions. This information can help them correct mistakes and avoid future errors.

Over the years, the quality control system has also been used to punish poor performance. By fiscal year 1993, States will owe nearly $3 billion in fiscal sanctions to the Federal Government, allegedly because of poor administration.

I use the term allegedly because there is clearly something wrong with our current system. In fiscal year 1984, all but five jurisdictions owed penalties to the Federal Government for poor performance. While I extend my heartfelt congratulations to Minnesota, Mississippi, Nevada, South Dakota, and the Virgin Islands, I cannot believe the AFDC program is poorly administered in every other State in the Union.

When the entire class flunks a test, the problem may not be the students. It could be the test, or, it could be the teacher. It is time for us to find out.

I am pleased that today we can begin to discuss solutions. In 1984, Congress asked the National Academy of Sciences and the Department of Health and Human Services to conduct studies of the AFDC quality control system and recommend solutions. In the meantime, we imposed a moratorium on the collection of any fiscal penalties. Today, both agencies are here to discuss their work with us.

Reforming the quality control system will not be easy. It will take time, and will involve a lot of technical detail, but it must be done. It is unrealistic to think that we can collect all of the outstanding fiscal sanctions. And it is counterproductive to leave these sanctions hanging over the States.

What we can do is establish a rational system that provides the necessary management information, broadly measures State performance, and punishes the worst performers.

I hope these hearings will help us to achieve this goal, and I am delighted to see my friend and the leader in this effort, Congressman Matsui. Bob, do you want to make an opening statement?

Mr. **Matsui**. Thank you very much, Mr. Chairman.

I first of all would like to thank you for holding these hearings and for your leadership in this particular area. I frankly think that were it not for your leadership at the current time, and of course Harold Ford's leadership over the past few years, we would not have gotten this far on this legislation.

As you know, and as others know, the moratorium on the sanctions will expire as of July 1 of this year. Should that happen, of course, many of the States in the Union will suffer either by reducing their administrative costs, which in turn will probably create more errors which is the irony of this whole situation, or as a reduction in benefits to recipients, something that obviously many of us in Washington and throughout the country do not want to see.

I think your comments, in your parting remarks, Mr. Chairman, were correct. We want to make sure that we penalize States that are committing serious errors that, in fact, reduce the amount of money available to needy recipients.

At the same time, we think it is absolutely unfair that clerical error, technical errors, and other errors like that are counted against the State and thereby reducing the level of their AFDC, Medicaid, and other type payments. I frankly think that some in the administration over the last few years wanted to use these funds for deficit reduction rather than for actual sanctions against the States in a fair and honest way.

I want to also, if I may, just take a moment to commend Senator Evans of Washington. He has been the leader on the Senate side. I have to say that this issue is a very complex issue, as he and you, Mr. Chairman, know. Only a very few of the Senators and House Members really understand this issue.

I do want to thank you for your leadership because frankly, were it not for you, Senator Evans, we probably would not have been successful in getting the leveling of the sanctions over the last few years.

I am hopeful that with the recent report from the National Academy of Sciences we now can get the ball rolling to come up with a real, permanent solution to this particular problem. And I can tell you that the problem is very, very severe.

I do not say this only because it is the State of California, because recipients all over the country could be affected by this, and where that person lives is irrelevant. But California, if no action is taken, just from fiscal year 1981 to 1984, we could have a loss of payments of $100 million. The State of New York could have a loss in excess of $100 million.

What is ironic is that States that have a better error rate than some other States are being penalized because of the way that the original 1981 amendment was framed. So it is my hope that we can come up with a comprehensive solution that makes some sense, and that we can protect the recipients which is really our first priority.

Thank you again, Mr. Chairman.

[The statement of Robert Matsui follows:]

OPENING STATEMENT OF
THE HONORABLE ROBERT T. MATSUI (D-CA) BEFORE THE SUBCOMMITTEE ON PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION
HEARING ON THE AFDC QUALITY CONTROL SYSTEM
TUESDAY, APRIL 12, 1988

Chairman Downey, I am pleased to be able to participate today in this important hearing on the AFDC quality control system and the need for reform. As you know, I am currently preparing to introduce legislation that will create an equitable AFDC quality control system. I first became involved in this issue during the Public Assistance and Unemployment Compensation Subcommittee's consideration of legislation to suspend the FY 1981 fiscal sanction for AFDC errors. During the debate on this measure, and subsequent heated debate thereafter, it became clear that a more comprehensive look at the purpose and effects of the quality control system was needed.

In response to that debate, I requested the formation of a working group composed of several state representatives and QC experts to develop legislation that would address the concerns which had come to light. Their initial proposal was embodied in H.R. 6295, which I introduced in September of 1984. After some refinement, this bill was reintroduced in February of 1985 as H.R. 1279. I have continued the process of research and refinement and I plan to introduce a revised bill this week which will represent the combined efforts of my staff, state representatives and advocates for low-income recipients of AFDC assistance. In addition, I have reviewed the recommendations of the National Academy of Science and the recently released HHS report to Congress on quality control in AFDC and Medicaid.

I am strongly committed to strengthening the safety net for the many people who find that they must rely on our public assistance programs. We must constantly strive in a realistic and responsible manner to ensure that our limited public assistance dollars go to those who meet the eligibility requirements. Therefore, controlling payment error is critical to maintaining the integrity of our public assistance programs, both from the standpoint of the low-income Americans who depend on them and the public who supports them through the taxes it pays.

Without question, an effective quality control system is an important and effective component of any public assistance program. Despite the many problems and legitimate complaints about the current quality control programs, states have made marked progress towards cutting their error rates by half or more: AFDC has reduced its error rate to 6.25 percent, the Food Stamp error rate has dropped to almost 8.1 percent and the Medicaid error rate has been reduced to 2.5 percent. Clearly, such a record is solid evidence of the states' commitment to running an efficient program.

The administration of our public assistance programs is a shared responsibility between state and federal governments, and it must depend upon cooperation to ensure efficient operation. Unfortunately, flaws in our current quality control program are damaging this cooperative effort. Provisions of the current quality control system threaten the federal and state financial partnership, turn program administration into a bureaucratic nightmare, and create an adversarial relationship between the federal government and the states just when cooperation is needed to continue the improvement in our public assistance programs.

While the Subcommittee does not have jurisdiction over the Medicaid and Food Stamp program, it is important to recognize that these three programs are often implemented by the same case workers in the field. To the extent that Congress imposes conflicting and constantly changing regulations on workers desperately struggling to keep up with a constantly changing caseload, Congress could be considered the cause of errors. The AFDC, Food Stamp and Medicaid programs have undergone major changes in the past few years. As a result, many states have been threatened with sizeable fiscal penalties for exceeding federally set tolerance levels. The magnitude of these changes could jeopardize the steady reduction of error rates that states have maintained over the past decade. Many states may be forced to absorb disallowance costs through reducing administrative funds, possibly resulting in even higher error rates, or worse, passing the cutbacks on to recipients through reduced or restricted benefits.

Without question, states must adhere to some form of quality control standards. To be effective, however, such a system must be implemented in a fair, timely and cost efficient manner. Our present system simply does not accomplish these goals. In fact, the General Accounting Office, the National Academy of Sciences and recognized experts have confirmed the existence of major deficiencies in the quality control system.

Under our current system, states have no opportunity to make corrections or recover overpayments to avoid sanctions after they have been informed of errors by the federal government. Furthermore, an inefficient two-tier system of analysis is used, in which state and federal officials duplicate error rate calculations.

The current system also appears to overstate the actual overpayment error rate. Questionable statistical procedures are used to develop the error rates, and states are penalized for client error over which they have little or no control. In additon, cases that have errors that are technical in nature, and when corrected do not involve misspent funds, are also counted in error even though these individuals remain eligible and the monthly payment is accurate.

Another major flaw in the current system is that it fails to take into account economic conditions, as well as significant geographic and program differences among states. Experts agree that demographic factors contribute significantly to higher error rates, yet there has been no effort to consider these factors when determining a state's error liability.

My legislation will ensure that error rate sanctions are fair and do not result in significant reductions of federal matching funds for recipient benefits or admininstrative needs. It requires states to continue to attempt to correct errors, but will not assess penalties for errors that are technical in nature and do not result in misspent funds. The bill will also set a more realistic error rate standard and adjust this standard to account for population variations and program as well as caseload designs that differ from state to state. The bill will also require changes in federal procedures for computing "good faith" waivers of state sanctions, and makes these decisions more timely and equitable.

The legislation I will introduce this week will also address treatment of underpayments and inappropriate denials with the quality control system. The National Academy of Sciences has recommended as an essential quality control reform that there be some sort of penalty for excessive erroneous denials and underpayments if there continues to be sanctions for overpayments. This recommendation rests on unchallenged evidence that sanctioning only overpayments causes denial errors.

The purpose of the quality control system is not to force states to cut benefits or develop more restrictive eligibility requirements. Neither is its purpose to shift costs from the federal budget to the state budgets, and it is certainly not intended to force states to cut back on administrative resources in a manner which will result in increased error rates in the future. The purpose of the quality control system is to help states improve the administration of their programs and to reduce errors, thus providing the most benefits to the greatest number of eligible individuals.

In light of these serious flaws and the counterproductive nature of impending sanctions, the states and Congress must work together to shape a quality control program that reflects a realistic picture of our income security programs. The quality control issue presents a unique challenge that can and must be met. I look forward to working with all of you here today to ensure that this issue continues to receive the necessary scrutiny it deserves.

Thank you, Mr. Chairman.

Acting Chairman **Downey**. Thank you, Bob.

We will hear first from our friend and colleague, Dan Evans, the senior Senator from the State of Washington.

I would point out that we all view with regret the Senator's decision to leave the Senate. He has been not only an able Governor of the State of Washington, but a fine friend and colleague in the Senate, and we shall miss him.

STATEMENT OF HON. DANIEL J. EVANS, A U.S. SENATOR FROM THE STATE OF WASHINGTON

Senator **Evans**. Thank you very much, Mr. Chairman.

In fact, I have considerably mixed feelings as I go through these last months of the year and of this Congress, partially because there is still much unfinished business that I would like to see accomplished before the end of this year, and this issue is certainly one of them.

The Congressman from California is certainly correct in that it is a complex, difficult subject, one in which few Members have the time to get acquainted.

My first experience, of course, came from the other end, as Governor, in trying to deal with the rapidly growing responsibilities we had with the advent of the Great Society programs of the late 1960s and the growing responsibility, as a result, of State governments to manage many of those programs and their expansion in the years after.

In many respects, I think the error rates which have crept in are as much a responsibility of those of us in Congress as anyone else. We, over the years, have added to the complexities by successive legislation, each proposal designed to bring some improvements in benefits or to make sure that we were focusing benefits better on certain groups. But every time we do that, we make the job more complex for the case worker who is on the firing line.

I just think it would be a marvelous idea for all of those at the Federal level who are involved in the error rate calculations, to go out and spend a few days right alongside a case worker and to find out just what it is like to deal with a 10-inch thick regulation book and with people who are, in many instances, not really capable of answering complex questions to establish their eligibility. They are frustrated, they are mad, and behind them is a long line of similar people who need help.

No wonder case workers, on occasions, do make errors and do make mistakes.

There is no question in my mind that the States of the Union perform a whole lot better than the purported, uniformly bad performance that is brought out by the error rate sanctions system. If you take all of the different functions, AFDC, food stamps, and Medicaid into consideration over the last several years, only one State, Nevada, has escaped sanctions in all of these particular programs. I do not think that Nevada necessarily is the only State of competence in dealing with this particular set of problems.

Mr. Chairman, I would ask that my full statement be placed into the record. Rather than going through it orally, let me immediately focus on the fact that I will shortly introduce legislation that hopefully, can be a base from which we all can work in trying to build a better system.

It will be legislation that is consistent with the National Academy of Sciences report and one which I believe will do what we ought to be doing, and that is to create a system that identifies the bad performers; that rewards the good performers, so there is an incentive for good management; and is not used, as the gentleman from California said—and I would agree with him—simply as a budget balancer by the current administration.

The legislation I will introduce will adopt a general approach advocated by the National Academy of Sciences by requiring States and HHS to negotiate performance standards for program administration. Included in this effort would be the elimination of the existing two-tiered sampling system. HHS and the States should agree on one sample and how it should be made. It will save sparse State resources and hopefully it will foster a more cooperative atmosphere between the States and the Federal Government.

Today the States have a very limited period of time to measure their own accuracy. Then it comes to the Federal level and of course the Federal Government has a much more extended period of time, a much more detailed opportunity to seek out and identify errors. I think that is an unfair and an unwarranted system. We both should be on the same level.

I concur with the National Academy of Sciences that we should reject the notion of a national tolerance level. In its report, the panel concluded, "that the current performance standards are not scientifically grounded and ignores State to State differences in case load mix that may be beyond the control of State administrators and that may influence measured performance."

Instead, I believe we should allow a State's error rate to vary according to population density, case load volume, and composition. For example, a standard deviation percentage could be established so that a State's error rate could be adjusted downward if it has an exceedingly high case load volume for a given quarter or if the case load composition consists of complex cases, such as those with earned income, which are very difficult for a case worker to identify fully.

We could provide a similar adjustment for States with large populations. Currently, I am reviewing the possibility of using measurements such as standard metropolitan statistical areas, the SMSA's, for this purpose. The SMSA is a statistic established by the Bureau of the Census to show where the population density is the greatest in the Nation. It measures not only the population of major cities, but also surrounding areas.

I do disagree with the panel's conclusion that the midpoint of the confidence interval provides the most accurate determination of a State's actual error rate within the statistical range. If that is not a mouthful, I do not know what is.

Basically, this conclusion is premised on the belief that the Federal Government should not have to shoulder the entire risk of administering income assistance programs. Stated differently, and much more simply, the State should not be given the benefit of a doubt that its error rate falls below that midpoint.

I believe the States should be given the benefit of the doubt. They have the responsibility of administering Federal programs which take care of the poor and I believe that is a national responsibility. My legislation will advocate use of the lower bound of the confidence interval as the most accurate and equitable measurement of State error rates.

This position, incidentally, was endorsed in a 1981 report on Federal income assistance programs by the National Academy of Sciences.

The National Academy of Sciences recommended that we broaden the measurement of performance beyond overpayment, which is what we do now. Thus, the State's tolerance level should be adjusted upward by an appropriate percentage by its underpayment rate. We do have both involved.

My legislation would include hold harmless periods for legislative and administrative changes that affect program eligibility. This provision will allow the caseworker on the front line time to assimilate the plethora of information he or she has to know to make a proper eligibility determination.

In the past, this has been a large contributing factor to State error rates.

I just think that every time we come up with comprehensive new legislation that requires the shift in the way we identify eligibility, we ought to give people some length of time for them to understand, assimilate, and to inform people so that proper management can be carried out.

I, along with the National Academy of Sciences, feel strongly that incentives as well as sanctions should be featured in any new quality control system. Thus, I am reviewing options for an incentive payment program that will be deficit neutral. These are the basic elements that will be included in this legislative proposal.

I hope that my legislation will serve as a discussion draft for further refinement and as a means by which we can work together to create a sound quality control system.

Mr. Chairman, let me stop there and respond to any questions you may have. It just seems to me that we have got to get back to the initial concept of error rate calculation. That was, as you said so well in your opening statement, to help States identify and, by identification, to improve their management of these various elements in the welfare system and, at the same time, we should penalize those who consistently refuse to improve their own management at the same time, I hope, that we can recognize those that do an exemplary job and reward them for that.

That, I think, is the best way in the world to bring overall error rates down.

[The statement of Senator Daniel J. Evans follows:]

STATEMENT OF SENATOR DANIEL J. EVANS

HOUSE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON PUBLIC ASSISTANCE

AFDC/MEDICAID QUALITY CONTROL REFORM

April 12, 1988

I. Introduction

Mr. Chairman, I am delighted to have the opportunity of testifying at today's hearing on reform of the AFDC and Medicaid quality control systems. During consideration of the 1985 Reconciliation Act, the Senate Finance Committee adopted provisions of legislation I had introduced earlier that year calling for the National Academy of Sciences to conduct a comprehensive review of the AFDC quality control system. The Committee expanded my proposal for a study and moratorium on the collection of penalties to include Medicaid.

By this action, Congress recognized that there were serious flaws in the existing quality control systems in federal income assistance programs. Congress called into question the validity of statistical procedures used to measure state performance. Congress stated that the purpose of quality control is not to raise federal revenues. That it was not to shift program costs from federal to state budgets, and that its purpose was not to reduce administrative resources which ironically will result in higher program errors in the future. We acknowledged that the purpose of quality control is to provide states with an effective management tool so that program administration can be as cost-efficient as possible. It is within this conceptual framework that we must approach reform of the AFDC and Medicaid quality control system.

Mr. Chairman, the time to fix the quality control system is now. As I have said on a number of occasions in previous testimony on this issue, there is something very wrong with a system which indicates that every state in the Union is an inefficient program manager of federal income assistance programs. In 1984, alone, 45 states exceeded the statutory tolerance level of 3%. From FY'81 to FY'84, a total of $597 million in penalties is pending against the states. After 4 years of official sanctions, all but 2 states have received a sanction for their error rates in the AFDC program.

It is time to stop recounting these sobering statistics -- everyone acknowledges the problem. We now are in a position to move ahead with reform. In the very near future, I intend to introduce legislation to establish a comprehensive system for quality improvement in AFDC and Medicaid. It will be consistent with the recommendations made by the National Academy of Sciences as well as responsive to the concerns of the states.

II. NATIONAL ACADEMY OF SCIENCES' REPORT

The National Academy of Sciences' report only underlined Congress' conclusion that the quality control system is in dire need of reform. I endorse the spirit of the panel's recommendations. Overall, I thought it was a comprehensive and thoughtful treatment of a very complex and difficult subject. Specifically, the panel concluded, "that the AFDC and Medicaid QC systems lack many of the elements of a comprehensive quality improvement system...(t)he QC systems offer little to state and local program managers in support of continued improvement in administration and in the achievement of other program objectives." I would like to highlight a few of their key recommendations.

- Federal monitoring activities for payment accuracy should be separated from other state and federal quality improvement activities. The panel made this recommendation to alleviate the ill-effects of the existing two-tiered system which hinders quality improvement and unnecessarily fosters conflicts between states and the federal government.

- Measures of quality should be set against broad program objectives, beginning with the language of intent in the AFDC and Medicaid titles of the Social Security Act. The existing system's exclusive focus on compliance with a numerical tolerance level does not reflect congressional concerns that states become better program managers.

- States should develop their own quality improvement strategies which reflect state-by-state differences in caseload composition, population density and other unique factors influencing their error rates. For accountability purposes, these plans would be federally-approved and would contain state performance standards.

- The new system should offer financial incentives consisting of both incentives and sanctions. Rewards and penalties should be calculated as proportions of the federal benefit dollars at stake. Standards should be set so that only states at the extreme of good or bad performance are subject to rewards or sanctions.

In summary, the report concluded that the existing system is replete with problems that impede states from becoming better program managers. It calls for an error rate that will take into account regional differences such as caseload and population. It recommends that a broader definition of error be used to measure the important policy objectives of quality control. It calls for a system that will provide an overall indicator of state performance. It envisions that only the extremely bad states will receive fiscal penalties and only the very good states will receive incentive payments. Most important, it recognizes that quality control is a management tool, not a federal revenue-raising device. Clearly, this report has provided us with the information necessary to start drafting legislation.

III. OUTLINE OF PROPOSED LEGISLATION

Mr. Chairman, I would like to share with the Committee, a rough outline of the major elements I will include in the legislative proposal I will introduce in the near future. It will adopt the general approach advocated by NAS by requiring states and HHS to negotiate performance standards for program administration. Included in this effort would be the elimination of the existing two-tiered sampling system. HHS and the states should agree on one sample and how it will be made. It will save sparse state resources and hopefully it will foster a more cooperative atmosphere between the states and the federal government.

I concur with NAS that we should reject the notion of a national tolerance level. In its report the panel concluded, "that the current performance standards are not scientifically grounded and ignore state-to-state differences in caseload mix that may be beyond the control of state administrators and that may influence measured performance."

Instead, we should allow a state's error rate to vary according to population density, caseload volume and composition. For example, a standard deviation percentage could be established so that a state's error rate could be adjusted downward if it has an exceedingly high caseload volume for a given quarter or if the caseload composition consists of complex cases such as those with earned income.

We can provide a similar adjustment for states with large populations. Currently, I am reviewing the possibility of using measurements such as the Standard Metropolitan Statistical Areas

(SMSAs) for this purpose. The SMSA is a statistic established by the Bureau of the Census to show where population density is the greatest in the nation. It measures not only the population of major cities but also of surrounding areas.

I do disagree with the Panel's conclusion that the mid-point of the confidence interval provides the most accurate determination of a state's actual error rate within the statistical range. I understand this conclusion is premised on the belief that the federal government should not have to shoulder the entire risk of administering income assistance programs. Stated differently, a state should not be given the benefit of the doubt that its error rate falls below the mid-point. I believe that the states should be given the benefit of the doubt. They have the responsibility of administering federal programs which take care of the poor -- a national responsibility. My legislation will advocate use of the lower bound of the confidence interval as the most accurate and equitable measurement of state error rates. This position was endorsed in a 1981 report on federal income assistance programs by NAS.

NAS recommended that we broaden the measurement of performance beyond overpayments. Thus, a state's tolerance level should be adjusted upward by an appropriate percentage for its underpayment rate.

My legislation will include "hold-harmless" periods for legislative and administrative changes that affect program eligibility. This provision will allow the caseworker on the front line time to assimilate the plethora of information he or she has to know to make a proper eligibility determination. In the past, this has been a large contributing factor to state error rates.

I, along with NAS, feel strongly that incentives, as well as sanctions, should be featured in any new quality control system. Thus, I am reviewing options for an incentive payment program that will be deficit-neutral. These are the basic elements that will be included in my legislative proposal. I hope my legislation will serve as a discussion draft for further refinement and as a means by which we can work together to create a sound quality control system.

IV. CONCLUSION

In conclusion, Mr. Chairman, we have made significant progress. The findings of the NAS study are detailed and significant. We now are in a position to initiate substantive reform. I believe we can accomplish this before the end of the

100th Congress. For example, I note that according to CBO's revised estimates, nothing will be collected from the states in AFDC penalties for FY'89. This estimate gives us a window of opportunity to accomplish reform in a deficit-neutral manner. If we wait until FY'90 or FY'91, the amount anticipated in collection begins to climb again. Thus, the longer we delay, the more difficult the task becomes. The number of states subject to fiscal penalties inevitably will reach 50, the amount of money pending in penalties will climb, states will not be able to improve their management efficiency with a continued drain on their dwindling resources. If they are forced to pay sanctions by our inability to act, they will be paid out of state program budgets. And in the end, we will end up hurting the program beneficiaries -- the very people we are trying to help.

Acting Chairman Downey. Senator Evans, you are in a unique position, having been both a Governor and now a Senator, to take a look at this quality control issue from both perspectives. Tell me, from your experience as a Governor, whether the threat of sanctions makes you more productive or less productive and what impact that would have on the operations of a typical State?

Senator Evans. I do not think there is a State where a Governor and the heads of the appropriate department do not try to do a good job. The assertion by some, including those who measure error rates at the Federal level, that because this is Federal money, the States do not pay much attention to it, I think is just nonsense.

We are concerned by the fact that every State is being pushed for adequate welfare resources. The AFDC grants are administered as a partnership program, in terms of the grants themselves. The State of Washington, as is the case in all States, funds 50 percent of the cash benefit. We are just as concerned as the Federal Government that the money appropriated is put out accurately to those who need help because the amount of money put out is half State money, if you want to put it that way. Ultimately, it is all the taxpayer's money.

But we are dealing with some people on the other end who really have one big problem, they have a shortage of money. We have a whole host of programs to deal with that one big problem. We have made them probably more complex than they need to be.

But I just reject out of hand the idea that States do not care, nor that they are incapable of doing a good job of management. They are just dealing with a system that has gotten probably far too complex and unnecessarily so.

Acting Chairman Downey. Given the current state of the legislative calendar, today as an example, I think we are going to be out of session by 1:30, do you think we have time to do your legislation in the Senate and Congressman Matsui's and mine here in the House, before the year is out?

Senator Evans. I think it is going to be tough. What it will take is doing a job in committee well enough and early enough so that we can report things to the floor. I would hope that we would have general acceptance on the floor by those who simply cannot pay definitive attention to it, but who have some confidence in those who have developed the legislation.

We have been very successful on the floor of the Senate, in spite of opposition by the administration in most instances, to put these moratoria in place so that we could develop this study and to build a new system. In every case, when that has come to a floor vote, we have prevailed by more than two to one. So I think there is a good atmosphere and quite a recognition, a growing recognition.

Every time we come up with one of these moratoriums, there is that much additional recognition of the problems we have got and the need to correct it.

Acting Chairman Downey. If we do not have the time, would you favor extending the moratorium another year?

Senator Evans. Indeed I would. I think that it is foolish for us to just feel that because we have a bad system and because it has listed a whole, very large, number of dollars against the various

States, that we should begin to collect them until we have a new system in place.

Now I surely think that at the very least we ought to extend the moratorium.

Acting Chairman **Downey**. Congressman Matsui?

Mr. **Matsui**. Thank you, Mr. Chairman.

I would just like to say, Senator Evans, if we have to extend it 1 year, that is the moratorium, you will then have to promise to stay in the Senate for an additional year because we are going to need your leadership over there on the legislation.

Senator **Evans**. Then I guess we had better get the job done this year.

Mr. **Matsui**. That is right. We better get it done this year, is, I guess, what I am really saying.

In your legislation, you make the variance for high case loads, complex cases, and other factors. Maybe you can explain why that might be important. We had the Governor of Michigan, Mr. Blanchard, testify, I believe it was 2 years ago. Back in 1981 and 1982, when we had the severe recession, it hit Michigan much harder than the rest of the country. As a result of that, they had a major surge of cases. And obviously, their rates of errors went up because they were overloaded, and they did not have time to train new caseworkers.

Could you explain why that is so important, in terms of the variations?

Senator **Evans**. I think you have gone a long way toward explaining precisely what the problem is. We ran into the very same difficulty in the State of Washington in 1970, I think you did in California, with the aerospace recession, which hit our State extraordinarily hard. Our statewide unemployment rate went from 3.5 percent to 13 percent in less than a year-and-a-half. We had exactly the same problem.

State revenues were headed downward with the recession, but the needs for State resources went up, as people went on welfare, as they went on unemployment, as they sought additional community college education to retrain themselves for the few jobs that were available. We just had a devil of a time trying to hire and train and get people on the line who could understand these complex regulations, dealing with a lot of people who are applying for welfare who had never been involved with welfare before.

So we had people who did not know the system on either side of the desk and it does lead, at least temporarily, to an understandable increase in errors. Eventually, it works its way back down, as the people are better trained and understand the system.

That is what I believe we should try to do. In some respects it may get more complex than we can afford to be. But at least in the major arenas, these rapid spikes in unemployment and welfare case load as a result, or the cases where there are major changes in legislation or, on a more consistent basis, I think the welfare case load is just simply more complex in some States than others.

In some of our States, there is a fairly consistent case load. It is the same kind of people, a much more understandable kind of case load. In other States, there are many, many differences, exacerbated by language difficulties and a whole host of other things that some States do not have.

That is why I think we should try to be more particularized in setting those error standards, instead of trying to do it on a national basis.

Mr. MATSUI. Thank you.

Acting Chairman DOWNEY. Mr. Brown.

Mr. BROWN. Senator, I am delighted to have you here this morning. I confess I am a bit surprised at your bad-mouthing the motives of the administration.

Senator EVANS. I was not bad-mouthing them. I am just suggesting that in spite of the need for revenues and to reduce the deficit, this is an inappropriate way to do it.

Mr. BROWN. Not to be argumentative, but I thought you took a cheap shot. I am serious. The policy of penalties is one that this Congress itself adopted. To attack the administration for advocating the policy that Congress has adopted by statute, is a cheap shot.

Senator EVANS. Well, the advocacy that the administration can take is one of several different approaches toward this whole thing. For instance, we could have had a suggestion coming from the administration that we have got a real problem. It is obvious that with 45 or 48 or 49 States under sanction, that something is wrong with the system, and they could have initiated that kind of thing. I would have hoped they would have.

They not only did not initiate it, they have been frankly opposing these efforts consistently all the way along.

Mr. BROWN. Frankly, the way you have outlined your bill, I think it has some real pluses. To provide an incentive as well as a penalty puts quality control in a proper framework by providing some positive incentive for the States.

The input we have received from the administration is, one, that they are following the law; and two, that they see these sanctions as a way to encourage quality control. I think you share those goals.

Senator EVANS. Oh, indeed. Surely I do.

I just think that we have, to the degree that—it has not just been this year or last year. This is something that goes clear back to the time I was Governor, so it preceded this administration. Perhaps it would have been more accurate to say administrations, generally, have not been enthusiastic about changing a system that consistently piles up more and more sanctions every year.

We were under sanction as long ago as when I was governor. I would have hoped, and still hope, that there will be some strong support from the administration for this new legislation, as a way of bringing ourselves back to a reasonable system.

Mr. BROWN. Do you think that having moratoriums sends a message to the States that to the States that we are really not serious about quality control?

Senator EVANS. No, I think a moratorium is important simply because these were unwisely and unnecessarily harsh penalties. If they had been accurately and rationally measured, we would not have had the kind of sanctions against many of the States that are now facing some very, very large penalties.

Even a State as large as New York or California facing a penalty of more than $100 million is a serious impact on the ability of those States, either to manage their welfare programs or to produce enough resources for the welfare grants themselves. So I do not think the moratorium—the States are frankly desperately hoping that we will come up with a better system.

I do not think a moratorium is anything other than a rational way to put things off until we get a better system.

Mr. BROWN. I take it your preference is to deal with the problem now?

Senator EVANS. Oh, of course. Of course. I would hope that we would be able to press intensively enough, recognizing that we have got a very tight time schedule this year and a lot of other very important pieces of legislation. Hopefully, we can get the corrections done and out of the way and behind us and cancel out the moratorium.

Mr. BROWN. Senator, I am intrigued by your legislation. It seems to be me a positive proposal, and we look forward to working with you.

Senator EVANS. Thank you.

Acting Chairman DOWNEY. Don.

Mr. PEASE. Mr. Chairman, I do not have any questions. I would just like to thank the Senator for his testimony. I think it is an example of the value of having former Governors in the legislative branch who have had some hands-on experience with actual administration. I salute you for your help.

Senator EVANS. Thank you.

Acting Chairman DOWNEY. Bill.

Mr. FRENZEL. Thanks very much, Governor, for your testimony. We really need people who understand the operating end of the QC system, rather than the end that devises all of the wonderful mazes that we must go through to cull out those who are less meritorious.

You are going to introduce a bill soon?

Senator EVANS. Yes.

Mr. FRENZEL. How soon is soon?

Senator EVANS. By the end of this week we are ready to go to the legislative counsel and hopefully they will act promptly and perhaps as early as a week from then we will have legislation ready to introduce.

Mr. FRENZEL. Do you have any House coconspirators?

Senator EVANS. Well, I hope that facing me are at least some who would be willing to join on. This is obviously the committee and the subcommittee that would have prime responsibility. As soon as we get draft legislation, we will share it with you and with this subcommittee, and hope that there will be others who will be willing to join with us.

Mr. FRENZEL. I have some of the same reservations that Mr. Brown has, about doing away with standards. And I think we want to be careful in that regard.

I like the general thrust of what you have presented this morning, but I also do not want to encourage sloppiness in the State operations. Now my own State, I hope it is not sloppy. It is a little open-handed.

Senator **Evans**. Open-handedness and sloppiness are two somewhat different things.

Mr. **Frenzel**. I know that Minnesota has QC liability of a third less than your State even though both States are about the same size. I have little respect for the AFDC system under which the potential penalties are levied, so I have a hard time deciding who is the bad guy, or if there is a bad guy in this situation.

That is what we have got to figure out, with your help.

It is not your intention to come to a system in which there are no penalties?

Senator **Evans**. Absolutely not. In fact, I do not think there are any good guys or bad guys. I think that when this system was put into effect, it was put into effect with the feeling that it was a good way to measure error rates and to apply sanctions when States got out of bounds.

But in practice, it has proven I think conclusively to be far too overbearing. Any time you have virtually every State in the Union under very big sanctions, that says there is something wrong with the system rather than something wrong with the States.

I do think we ought to retain standards. I do think the standards ought to be crafted so that we do not try to fit every State into the same shoe, that there are just inherent differences in the kind and makeup and intensity of their welfare recipients, that you can set some standards that do recognize those differences.

Once having set the standards, we ought to continuously review them and I would hope we would come up with a system that ultimately would have a few States good enough that they would qualify for incentive payments for exemplary management and a few States who were careless enough that they were subject to some real sanctions.

If you had a system like that, knowing how the Governors get together and their counterpart department heads get together at national meetings, nothing spreads faster than an example of success. If you have a few States who are getting payments for good work, incentive payments, I will bet those measures of success will spread pretty rapidly and will have the effect of lowering error rates clear across the country and accomplishing what we are all trying to get to.

Mr. **Frenzel**. Great. I think you have given us good goals to strive for, and I hope our staff will be working with yours, as you develop this bill. And let's show enough speed so that you will not have to retire unfulfilled.

Acting Chairman **Downey**. Thank you, Senator.

Senator **Evans**. Thank you very much.

Acting Chairman **Downey**. The committee will hear next from the National Academy of Sciences.

I would like to point out to the gentleman from Minnesota that his State is one of the holy five, whose error rates are below the national minimum. If you owe penalties, it is for food stamps and Medicaid, not AFDC.

STATEMENT OF JOHN NETER, CHAIR, AND FREDRICA D. KRAMER, STUDY DIRECTOR, ACCOMPANIED BY HELEN B. O'BANNON, MEMBER, PANEL ON QUALITY CONTROL OF FAMILY ASSISTANCE PROGRAMS, NATIONAL RESEARCH COUNCIL, NATIONAL ACADEMY OF SCIENCES

Mr. **Neter**. Mr. Chairman, and members of the subcommittee, I want to thank you for asking the National Research Council to present its findings on the quality control systems in the AFDC and Medicaid programs. As you know, Congress mandated this study in the Consolidated Budget Reconciliation Act of 1985, and we are discussing today the report that was formally transmitted to the Congress and to this subcommittee on February 23. I request that the summary of that report be inserted in the record of these hearings.

Acting Chairman **Downey**. Without objection, all of the testimony that the committee will hear will be placed in the record in its entirety.

Mr. **Neter**. By way of a brief introduction to our presentation today, the NRC's panel, which was convened within the Committee on National Statistics of the National Research Council, comprised 14 experts in the fields of statistics, quality control and welfare administration. I am a statistician and chair of that panel. Fredrica Kramer, the panel study director and editor of the report on which we speak today, will give the first statement outlining the basic structure of the new system that we recommend be implemented. I will then discuss the panel's response to your second charge, to what should State be held financial accountable, including the details of the measurement and estimation system that we recommend, as well as how we recommend clearing up the backlog of past sanctions.

Helen O'Bannon, a member of our panel who is past secretary of the Pennsylvania Department of Public Welfare and currently senior vice president of the University of Pennsylvania, is here to discuss some of the panel's conclusions that you may want to pursue. She will not have a separate opening statement.

We will begin with Ms. Kramer.

Ms. **Kramer**. Thank you.

The panel recommends an entirely new system for quality monitoring and quality improvement. Although the current system has made new information on program performance available to both States and Federal administrators, and it has clearly built substantial resources at the State and Federal levels, and has reinforced an interest in running programs with integrity throughout the system, the panel finds that the system is not working very well. Indeed, the frustrations with it and the contentiousness that it has created between Federal and State agencies is, as you know, part of the reason for these studies. Correcting the system, the panel feels, requires an entirely new approach.

Administering welfare is complicated. The family assistance programs have the difficult job of providing needed support while reducing dependency and facilitation self-support. These objectives are complex and they are often inconsistent. The basic tools that the programs have to provide the services are largely limited to those used for eligibility and benefit determination and they are often performed by minimally trained workers. The programs are thus dependent upon many kinds of services and activities and factors quite beyond the bounds of the local welfare agency to accomplish their mission. To protect the public's interest in ensuring that benefits go to the right people and to no others, elaborate tests accompany the rules for determining and redetermining eligibility. Because of the programs' histories, as you know, programs and policies are highly variable between States and even often within States from district to district, with administrative jurisdictions that criss-cross all the way down from the Federal level to the local delivery agency. That makes prescriptions particularly difficult about how to improve management difficult to make from the outside and difficult to generalize. But the frustrations and expectations about welfare remain very high. That is obviously indicated by persistent efforts at reform and frequent changes in rules and regulations. The manuals and other materials that front-line workers use to perform the basic eligibility functions reflect the complexities and that pace of change and they make administration that much more cumbersome.

The QC systems are not helping very much to improve program management or program effectiveness. While payment error rates have declined nationally since the systems began, there is little good information on how to improve more. States cannot know, for instance, whether redesigning their forms or changing their training and staffing strategies, or persuading you as policy makers about the efficacy of proposed changes in rules or program design, would best reduce errors. States and you, as Federal policymakers, have no certain way of knowing what real capabilities are. Without that, Federal performance thresholds are essentially arbitrary and may even seem increasingly unattainable.

Both States and Federal policymakers need to know how well they are accomplishing basic program objectives. Yet by monitoring only one, albeit important, concern—improper payments—they may even distort incentives to achieve those other basic objectives. The use of the two-tiered measurement system has generated its own conflicts and created even further potential for bias and inaccuracy. In sum, the systems have not produced data on the causes and cures of error at sufficient levels of detail, or generalizable information as would have been produced from systematic experimentation and rigorous evaluation, that could help States and local offices know what to spend scarce administrative resources on to make improvements to better achieve the program objectives that you set forth.

There is a long history in statistics and operations research and management sciences about how to implement effective quality management systems, systems that include both quality control and quality improvement. That history persuades the panel that a quality improvement system, especially in this kind of environment in which routine tasks are complicated and the overall system is in flux, requires information about whether or not basic procedures are being followed, or whether the system is performing up to its capability but the processes and programs need to be redesigned in order for further improvement to take place. To understand this in terms of the current QC systems, one must measure both what the true error rate is, measured on all important dimensions of the objectives of the program, and as well how workers are performing, whether they are working up to their capability in the system as designed or whether you need further improvement. Without the first, that is, what the true error rate is, you cannot know how well you are doing overall and whether that is good enough. The second tells you whether you are doing as well within a given system as you can and lets you make choices about how and at what cost you can get closer to your chosen standards. Each requires different studies, different samples, different measurements. The QC systems have faced this issue before in their histories, but have never managed to serve both purposes together.

The panel recommends that the Congress and the Federal agencies move quickly to build a new system that will provide the necessary tools to measure and maintain performance at the limits of capability, and to improve through the redesign of programs and processes to serve the objectives for which the programs were designed.

I would like to summarize the four overall recommendations that the panel recommends to structure the new system. First, to begin this system, the State quality improvement efforts must be disentangled from the necessary but very separate function of Federal monitoring for payment accuracy. In short, the current two-phase review process should be replaced by one Federal sampling, review, and estimation system for financial monitoring, with State capability to review cases in dispute.

Second, the panel finds that management improvement must be for the purpose of serving program objectives. Hence, measures of quality must reflect those objectives. Importantly, they should not monitor on only one dimension to the potential disservice of others. Quality control as currently conceived, the panel says, is a misnomer. The quality of the family assistance programs clearly encompasses broader dimensions of performance than payment accuracy. Performance standards, particularly those to which States should be held financially accountable, are difficult often to specify. Some may in fact prove easy to specify, such as timeliness or child support collections. Other standards will certainly require more complex study. Some standards should be used to encourage coordination and integration of all of the social programs and activities needed to accomplish the objectives of Medicaid and AFDC.

Finally, some standards may best be enforced through financial penalties. Some others may be more effectively enforced through other mechanisms such as mandating program reorganizations based on performance findings. The panel recommends the study take place over the next 5 years, this is detailed in its recommendation four, to develop new quality measures, particularly those to which States should be held accountable.

Third, the panel recommends that States develop their own quality improvement systems but with Federal help. States are too diverse and Federal officials have too few resources currently to offer really meaningful assistance. Federal agencies can and should facilitate access and financial and regulatory support to technical expertise in order to support the design of process control tools, as the panel says, rigorous evaluation of program and process design innovations, and OFA and HCFA should disseminate the results of those studies so that States and the Federal agencies as well can learn from research and from other State experiences what works.

Fourth, the panel offers ways to ensure that the necessary transition take place from quality control to quality improvement. It recommends, in order to do this, a 5 year mandated maintenance-of-effort using 1987 QC expenditures as a base—adjusted for inflation—for two purposes, to protect States from using their current QC appropriations to competing State budget commitments and to ensure continuing Federal support. It recommends during this 5-year period funding of demonstrations to ensure careful evaluation of the new activities, and to ensure that ordinary administrative expenditures are not masked as special quality improvement efforts.

And it also recommends using the 5-year period to develop the new performance standards and to specify at the end appropriate levels of support for continued quality improvement, which it cannot now specify. The recommendation also details reporting requirements to Congress of the results of these transition activities.

Once States are given the proper tools for improvement through the mechanisms described in these recommendations, Congress should expect to find few States performing poorly enough to impose sanctions.

Dr. Neter will detail the financial monitoring system that the panel recommends in such instances, as well as the panel's recommendation for clearing the backlog.

Thank you.

Mr. **Neter**. Our panel recommends a new system for financial monitoring in the future based, as with the new quality improvement system, on basic principles of modern quality control and quality management. The classic view of quality control is that performers should be held accountable to rules that are understood and agreed upon and for procedures over which they have control. Quality improvement systems should be designed to identify and distinguish common, or systemic, problems from those that are assignable to individuals performing in the system. When a system is operating at attainable levels of performance, the quality control system should sanction and reward only those at the extremes of good or bad performance. The current system of monitoring and measurement that finds nearly all States doing poorly in the fact of a record of general improvement indicates that either the standards are too stringent or the QC system has failed to put in place the mechanisms that could help States reach the desired standards in the required period of time, or both.

The panel's recommendations on how to establish fiscal sanctions do not presume to suggest to you proper thresholds or target error rates. These are, in large part, policy choices. And the panel, in any case, has no empirical evidence upon which to base such choices. Also, these thresholds should change over time to reflect changing capabilities. Rather, the key elements for setting standards, which we have outlined in recommendations five through nine, need to be taken as a whole, which, when operating together, will set the magnitude of sanctions and rewards.

Turning now to these recommendations. First, the system should contain rewards as well as penalties. Incentives are essential components of systems designed to encourage changes in performance. Hence both positive as well as negative encouragement should be used. Also, such rewards and penalties should be calculated as proportions of the Federal benefit dollars above or below chosen thresholds, but these thresholds should be chosen so as not to create problems in the delivery of program services or, in the case of rewards, to create windfalls for any State.

Financial sanctions, in our view, are tools to improve quality, not instruments for fiscal management or deficit reduction. In light of Congress' current concerns, this point needs special emphasis.

The panel was also very much concerned that State agencies not pay penalties at the cost of reducing needed services, and importantly, that they make needed improvements. We therefore recommended, in recommendations five and six, careful monitoring of those States subject to sanction and that special payback schedules be considered to guard against such dysfunctions. And for the few really poorly performing states subject to penalty, we recommend that a special fund be set up, such as a Secretary's discretionary fund, to provide aggressive technical assistance with experts both from within and outside of Government free from regional office constraints. Since fewer States should be in this category, this approach seems especially feasible and attractive.

Second, rewards and penalties should be based on reliable measures of program quality, defined against the basic objectives of the programs. We recommend beginning with four types of payment accuracy—overpayments, underpayments, payments to ineligibles, and improper terminations and denials—each important and each should be weighted to reflect this. Measures of performance to which financial consequences are attached create powerful incentives. Inclusion of some to the exclusion of others can create real perversities and we detail in the report the kinds of measures that ought to be explored, and mechanisms for reporting back to Congress as new measures are developed to which States should be held accountable. Especially important are measures that capture the different program objectives and how they interrelate, and those that would encourage effective coordination across programs and services to help achieve desired objectives.

On a related matter, we recommend against including so-called technical errors in the calculation of rewards and penalties. Certain procedural requirements are important for providing a form of internal control. Others appear to be serving as surrogates, though poor ones, for measuring the achievement of program objectives—such as WIN registration as a surrogate for participation in work or training—in some cases even creating perverse responses from the States. Better measures should be sought.

Third, the criteria against which performance should be measured should be established as contractual agreements in Federally approved State plans, and time should be afforded for implementation of new rules or new program designs before errors arising from them are counted. As stated earlier, the current system mixes two tasks, both legitimate but each useful for different purposes. One is to evaluate a State's performance according to procedures established to control error. The other is to try to assess the true level of error so that procedures may be improved to better control such errors. States should be held accountable for procedures over which they have control. The States and the Federal agencies should continue to monitor true error through both routine and special studies and find new procedures and system designed to better control it. These points cannot be overemphasized. They address one of the principal sources of contention in the current system and compromise both State and Federal interests as a result.

Fourth, the action limits, the thresholds, that determine sanction and rewards should adjust for State-to-State differences in order to reflect the limits on performance over which States have no control. Past evidence suggests that differences in caseload composition for households with earnings, households with elderly, and all others are probably sensible candidates around which to construct such adjustments.

Finally, standards should change over time so as to continually reflect changes in capabilities.

To summarize these important elements: reward as well as penalize against some proportion of Federal benefit dollars; monitor the consequences of sanctions and provide real help to the few poorly performing States; start with four types of payment inaccuracy, but add to those measures over time; hold States accountable to performance established in State plans; and adjust for State-to-State differences in capability, and for changes over time.

Under this new system, the panel also recommends that a process be devised to ensure that State review of Federal findings can be done through the national office for the timely resolution of differences.

In addition to these basic elements the panel makes a number of technical recommendations aimed at correcting certain types of measurement and estimation questions that may lessen contention in the future over measured error rates. These include the regular and rigorous assessment of measurement error and bias, the routine reporting of sampling error, and the design of samples to achieve equal precision across States.

The panel's solution to clearing the backlog is largely a response of expediency to deficiencies in the current measurement and estimation system. These create concerns about the validity of current error estimates but cannot be corrected for the past. Let me turn to this issue now.

The panel believes strongly that the backlog should be cleared as quickly as possible so that attention can be directed to developing the new quality improvement system in an atmosphere in which it has a chance to succeed.

Because there are uncertainties about the presence of measurement errors in both Federal and State determinations, because past standards are not related to capability, and because current estimates contain inappropriate standards including technical errors and State differences in caseload composition that contribute differentially to error and over which the States have no control, the panel believes that the most defensible criterion for judging whether a State had an excessive error rate in the past, is in relation to the performance of other States, not in relation to legislated standards. We emphasize that this is a solution of expedience, to permit you in the Congress, the Federal agencies and the States to get out of the current dispute and get on with the job of quality improvement.

Specifically the panel recommends that state error rates be grouped into a distribution and those states that are outlying with very large error rates be subject to sanction. Two issues arise with such a solution. One is what error rate do you use, what combination of Federal and State determinations, and the other is where do you draw the cutoff.

The panel examined several statistical alternatives to estimate an official error rate, including the currently used regression estimator. We note that the problem of merging the State and Federal samples by use of a regression estimator or some other statistical tool would not arise in the one-tier system the panel recommends for the future.

The regression estimator specifically had been questioned on several grounds and these are detailed in the report. But the issue of what kind of estimator to choose rests largely on whether Federal determinations or State determinations or some combination of the two best represent the true error rate for that State for the past. The panel offers guidance on the choice of an appropriate estimator depending on which review findings, or combination, one feels would represent the better measure.

The panel also offers statistical guidance on how to construct the distribution to define the true outlier. Where to draw the cutoff on the distribution of State error rates, that is, how many and which States to sanction as extremely poor performers, is a policy choice. Common statistical practice would use a criterion of 5 percent or 1 percent probability of misclassifying a State as an outlier. By the analysis detailed in the report, we expect that there may be considerable agreement on the worst performing few States, if you are only looking at the outlying one or two States or programs for a given year, no matter which estimator is used.

However, if Congress wishes to penalize more than the few states so identified, the choice of estimator becomes increasingly important the more states are chosen for sanction, and may significantly influence which States are sanctionable. No unequivocal statistical guidance can be given on that choice. If, for example, Congress chooses for other reasons to penalize say, the 10 States with the highest error rates, the panel urges it to consider mitigating the amount of sanctions levied.

That concludes our summary. We would be happy to respond to your questions or comments.

[An attachment to the statement follows:]

From Quality Control to Quality Improvement in AFDC and Medicaid

Fredrica D. Kramer, Editor

Panel on Quality Control of Family Assistance Programs
John Neter, Chair

Committee on National Statistics

Commission on Behavioral and Social Sciences
and Education

National Research Council

National Academy Press
Washington, D.C. 1988

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This report was prepared for the Food and Nutrition Service, U.S. Department of Agriculture, and the U.S. Department of Health and Human Services under contract number 53-3198-6-29. Points of view or opinions stated in this document are those of the contractor and do not necessarily represent the official position or policies of the Food and Nutrition Service and the U.S. Department of Agriculture or the U.S. Department of Health and Human Services.

Printed in the United States of America

Available from:
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National Research Council
2101 Constitution Avenue, N.W.
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Preface

Controversy attends the quality control (QC) systems in the AFDC, Medicaid, and Food Stamp programs. That controversy, and the depths of feelings of all who have made their interests known to this panel appointed by the National Research Council, have made our task challenging and meaningful. The mandate to which the panel responds required that the panel report first, and therefore separately, on the Food Stamp program. While this has made our task somewhat more difficult, it also gave the panel an opportunity to continue deliberations on some of the more vexing issues and to present in this report a more complete solution. This report rounds out and completes the panel's work.

The panel would like to acknowledge all of the people who have given their assistance to, and provided support for, the panel's work. Many people offered their time, opinions, analyses, and insights into quality control on the basis of their experiences in actual applications. Individuals in public service and private firms, representing particular interests or their personal views, made significant contributions to our work. Many people in federal and state government and in various interest groups also provided help. The panel could not have completed its work adequately without the access to state and local program operations that these people provided. Unfortunately, there are too many to be acknowledged here individually. The panel is most grateful to all these people for their contributions.

The panel itself consisted of individuals with varied experiences and views, some forged in public service and others in the disciplines of statistics and quality control. These views created intensive debates. In the end, this report represents a basic and fundamental consensus. David Swoap's disagreement and ultimate dissent on one fundamental issue—that of the proper scope of quality control in the family assistance programs—helped hone the panel's majority view on this basic issue. It has been my pleasure to chair a panel that was able to discuss the complex issues constructively and arrive at a final report to which all panel members contributed in important ways.

The panel is greatly indebted to its staff for their effective work, particularly to the panel's study directors. Dennis Affholter served through the summer of 1987, and Fredrica Kramer took the panel through the high-pressure production of this report and the resolution of difficult technical issues. This report offers much new material and reshaping of earlier work, but also draws much from the earlier report on the Food Stamp program. Hard work by the staff enabled different views within the panel's consensus to be accommodated in this report.

The panel would also like to express special appreciation to other staff members, many of whom joined the staff after completion of the initial Food Stamp study, to assist with the AFDC and Medicaid studies: Gary Causer, for his efforts in the assessment of modern thinking about quality and of some of the statistical issues before the panel; Ann Ryan, for a variety of policy and program analyses and much help with the site visits; Elaine Carlson, for help in the analysis of federal and state efforts in quality control and certain statistical data; Jay Sternberg and Marlene Glassman, for program descriptions of AFDC and Medicaid; and Elaine McGarraugh for statistical analyses of alternative estimators and for much help on editorial production. We are also indebted to several consultants who assisted the panel by developing working papers on a variety of subjects: Michael Cohen, Tore Dalenius, Richard Royall, and Wray Smith; and, for this report in particular, Philip Moss, for his simulation studies of alternative estimators, and Frank Yeager, for his assistance in the site visits and analysis of state and local operations.

The panel appreciates the assistance and support given it by staff officers of the National Research Council. David Goslin, former executive director of the Commission on the Behavioral and

Social Sciences and Education, and P. Brett Hammond, associate executive director, provided the institutional backing to expedite every step of the process, from proposal development to review and release of the report. Eugenia Grohman, associate director for reports of the commission, provided exceptional assistance in all aspects of the editing and production of the report under tight deadlines, and staff and panel are grateful for her wisdom and perseverance. Edwin Goldfield and Miron Straf, former and current directors of the Committee on National Statistics during the term of the panel, offered their support, and that of the committee, in the initial establishment of the panel and throughout the panel's work. Reviewers of this report from the commission and from the committee must be especially thanked for making suggestions that led to greater clarity and substantial improvements in the panel's report.

Finally, I wish to express my sincere thanks and appreciation to the members of the panel for their large contributions of personal time and expertise to this effort and for their good will in bringing out divergent views and yet pushing for consensus on many difficult issues. The panel's recommendations reflect the richness of the discussions and each member's significant contributions. Biographical sketches of panel members and staff appear in Appendix C.

I look forward to the discussions of this report and of related ones as they are considered by Congress. I hope that those discussions will be assisted by the labors of this panel during the past 2 years.

John Neter, Chair
Panel on Quality Control
of Family Assistance Programs

Summary and Recommendations

SUMMARY

Background

This is the second and final report of the Panel on Quality Control of Family Assistance Programs. The controversy that gave rise to the study is about money: who should pay—and how much they should pay—for payment inaccuracies to recipients of family assistance. But that controversy raises issues that have been at the core of national family assistance policy for at least two decades. The issues concern how to organize welfare assistance at federal, state, and local levels, whether and how programs can be better managed, and toward what ends they should be managed. This report tackles only a small part of the controversial welfare debate. But it presents a framework, introduced in the panel's first report on quality control in the Food Stamp program, for improving the quality of management in all three major family assistance programs and for holding states accountable for program performance.

Beginning in 1981 financial penalties were levied against states with excessive overpayment errors to participants in the three major family assistance programs—Aid to Families with Dependent Children (AFDC), Medicaid, and Food Stamps. Almost all states have filed administrative appeals in the U.S. Department of Health and Human Services (HHS) and the U.S. Department of Agriculture on the basis of notifications of penalties; several states have brought suit for fiscal 1981 through 1983 sanctions in the Food Stamp program, and suits for subsequent years and all programs are possible. It is estimated that under the current penalty systems, the total financial liabilities of the states for such errors in the three programs will be at least $3 billion by 1989.

In the face of accelerating confrontation and litigation, Congress acted. The Consolidated Budget Reconciliation Act of 1985 (signed in April 1986) directed the secretary of HHS to study the quality control (QC) systems used for AFDC and Medicaid and to contract with the National Academy of Sciences for independent studies of these same systems. The Panel on Quality Control of Family Assistance Programs was set up to carry out these studies, as well as a similarly mandated study of the QC system in the Food Stamp program, which resulted in the panel's first report (Affholter and Kramer, 1987).

The congressional mandates contain two charges: (1) to study "how best to operate" the QC systems "in order to obtain information . . . to improve the quality of administration" of the programs and (2) to provide a reasonable basis upon which to withhold federal funding from states with "excessive levels of erroneous payments." Since improving the quality of administration must serve the achievement of program objectives, maintaining financial accountability must also be linked to those ends.*

In this report the panel recommends a new system to replace the current QC systems for the AFDC and Medicaid programs, as it did for the Food Stamp program in its first report. The basic framework for this new system is the same as that recommended for the Food Stamp program. In addition, however, the panel's analysis and findings in this report address intergovernmental and interprogram complexities that particularly affect state and local delivery systems for AFDC and Medicaid.

Family Assistance Programs, Quality Control, and the Current Controversy

The Office of Family Assistance (OFA) in HHS is responsible for the AFDC program. Fiscal 1987 federal expenditures for

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* A panel member dissents; see Appendix A.

AFDC were approximately $8-10 billion. The Health Care Financing Administration (HCFA) in HHS is responsible for Medicaid. Federal expenditures for Medicaid in fiscal 1987 were approximately $27 billion. These two programs, together with Food Stamp expenditures, account for approximately 40 percent of federal spending for benefit programs to assist the poor.

Both the AFDC and Medicaid programs are administered by the states, either directly or through local agencies, and often by the same agency. States and the federal government share in the benefit costs (payments to or on behalf of recipients) of both programs and states exercise a variety of policy prerogatives.

The QC system for AFDC was established in 1964 and changed in 1970 to the QC system now used; the AFDC QC system provided the model for both the Food Stamp and Medicaid systems. The quality control systems in all three programs focus primarily on—and impose penalties only for—one type of payment inaccuracy: overpayments to (or on behalf of) eligible households or individuals and payments to (or on behalf of) ineligible households or individuals. Underpayment errors (and improper terminations and denials) are measured, but they are not part of the penalty system. In addition, the current QC systems do not, for purposes of holding states accountable, measure the achievement of program objectives other than payment accuracy. Hence, the timely provision of benefits to eligible applicants, effective coverage of all those eligible and wishing to receive benefits, or the effect of receipt of cash or Medicaid benefits on the achievement of self-sufficiency, for example, cannot be monitored through the current QC systems.

The imposition of financial sanctions and disallowances on state agencies began for fiscal 1981. Currently, the "official payment error rates" on which state-level performance standards are based are set at 3 percent for AFDC and Medicaid. Official fiscal 1984 estimates of the national payment error rates were 6.0 percent for AFDC and 2.7 percent for Medicaid.

The current controversy exposes the divergence of interests among those concerned with the administration of family assistance programs and the appropriate use of QC systems in them. To the federal government, the penalties represent one way of controlling program costs due to fraud and abuse and other "misspent" funds. To some representatives of client interests, the QC systems raise concerns about denial of needed benefits. To the states, the systems represent a combination of these concerns, perhaps dominated by their financial liabilities resulting from QC-based disallowances. The panel finds that each of these perspectives represents policy objectives that "quality control" and management improvement systems can and should address.

The Quality Control Systems

Sampling and Reviews

The QC systems for both the AFDC and Medicaid programs have been characterized as a two-tiered system of state and federal government activities. State program officials sample monthly from their active cases and negative case actions (terminations or denials of benefits), and state QC reviewers verify the accuracy of eligibility and benefit determinations in the sampled cases. Federal officials in regional offices subsample the completed QC reviews and re-review those case findings.

The state AFDC and Medicaid sample designs and sampling procedures must be approved by OFA and HCFA, respectively, and must meet prescribed standards for probability samples with minimum specified sample sizes (which vary with the size of a state's caseload). Federal law and regulations provide the standards for QC review findings. Federal-state disagreements on case findings are resolved through an appeals process.

Estimates of Error Rates

State AFDC case error rate estimates computed from the QC sample and review include case errors due to ineligibility, overpayments, underpayments, and erroneous negative case actions. Payment error rates are also computed for payments to ineligible recipients and for underpayments and overpayments to eligible recipients. However, fiscal sanctions are based only on the combined payment error rates for ineligibility and overpayments. Procedural errors unrelated to a recipient's need for assistance are included in all AFDC error rate calculations.

For AFDC, the official payment error rate used to determine fiscal disallowances is based on the federal sample review data adjusted by data from the state sample reviews to improve precision, using a regression adjustment procedure. The regression adjustment procedure is also used to calculate case error rates and payment error rates for ineligible, overpayment, and underpayment errors.

For Medicaid, the payment error rate is the ratio of erroneous payments on behalf of ineligible cases divided by the total dollar amount of claims paid. Technical errors are not included in the estimate nor are errors, claims, or payments for SSI recipients. The regression-adjusted error rate is determined for Medicaid similarly to AFDC, except that a separate estimate is calculated for both the numerator (average error payment) and denominator (average payment) of the error rate.

Performance Standards for Fiscal Disallowances

Standards on which disallowances are based began at 4 percent in fiscal 1981. The current standards of 3 percent went into effect in fiscal 1984 for AFDC and in April 1983 for Medicaid.

If a state's official payment error rate is higher than the established performance standard, the state is notified of its potential liability for sanction. On the basis of that error rate, OFA or HCFA "disallow" the federal financial participation for the amount that the state's error rate exceeds the performance standard. For fiscal years 1980 through 1984, the measured national payment error rate declined for both AFDC and Medicaid: for AFDC, measured rates were 7.8, 7.7, 6.9, 6.5, and 6.0 for those years; for Medicaid, the rates were 5.1, 3.8, 3.8, 2.8, and 2.7 for those years.

For both AFDC and Medicaid, states may request a waiver from total or partial payment of disallowances. These waivers allow states to be excused for factors that generate error and are outside their control. Of the 27 states that exceeded the target error rate for AFDC in fiscal 1981, 6 states were granted waivers. For Medicaid in fiscal 1981, HCFA granted waivers to 3 of the 12 states that requested them. For both programs, states may appeal the federal disallowance to the HHS Grant Appeals Board if not satisfied with the waiver request decision.

Evaluation of the Quality Control System

Strengths and Weaknesses

The panel finds that the AFDC and Medicaid QC systems have certain strengths, which should not be lost in efforts to improve them. The current systems produce and report annual estimates of state payment error rates and sources and types of errors, by state and for the nation as a whole. Before the QC systems were in place, this kind of information was unavailable except through limited special studies. Compared with some public programs with similar missions, the QC systems used in the family assistance programs are relatively sophisticated. And there is a pervasive emphasis on doing good work that is reinforced by the QC systems.

The current QC systems, however, primarily serve the federal government's interest in monitoring one measure of quality, certain types of overpayments. The QC systems offer little to state and local program managers in support of continued improvement in administration and in the achievement of other program objectives. The QC emphasis on overpayments might even lead to the neglect or detriment of other objectives. Some critics of the QC systems, for instance, claim that "case churning" (recipients or eligible applicants losing benefits for a short time, for procedural reasons) is a direct result of eligibility determination procedures designed to protect against the possibility of overpayment errors. The current QC systems also fail to address the problem of state agency responses to QC-based liabilities that may directly conflict with the achievement of other program objectives.

The panel finds that continued interest in program improvement and in a variety of public policies to help achieve program objectives clearly reflects interest in broader measures of quality than payment accuracy. Yet defining quality and monitoring performance against quality measures is difficult; program objectives are complex and sometimes inconsistent. Administrative process at the service delivery level in AFDC and Medicaid is remarkably complex. States have no certain way from current QC and corrective action efforts of knowing what their current performance capabilities are. Without such knowledge, federal performance thresholds remain essentially arbitrary, and state and localities have little way of knowing where to focus their energies for improving performance. In addition, states have diminishing incentives to meet federal standards, which themselves may seem to be increasingly unattainable.

The panel concludes that financial consequences—including both penalties and rewards—ought to be used to promote improved performance on a broad range of program objectives. The panel also concludes that the current performance standards are not scientifically grounded and ignore state-to-state differences in caseload mix that may be beyond the control of state administrators and that may influence measured performance. The panel finds problems with the current two-phased sample design and the measurement and estimation system now used in all three family assistance programs to determine official payment error rates. Such problems include apparent inefficiency and the potential for measurement error, with no currently systematic monitoring of the accuracy of the measurement process. In addition, QC sample designs cause the reliability of state-level estimates to vary from state to state. As a result, the risk of oversanction or undersanction due to sampling error varies from state to state. HCFA and OFA do not routinely calculate and publish estimates of sampling error.

The Concept of Quality Improvement

Quality improvement experts take a broad view of quality and management aimed at improving it, and the panel finds that view relevant to the AFDC and Medicaid programs. Quality improvement involves a broad range of activities designed to assist in the achievement of program objectives. Systems for quality improvement include three kinds of activities: process control, process improvement, and service or program improvement. Process control is concerned with maintaining performance at the limits of capability of a process as designed. Process improvement examines possibilities for process redesign to improve performance capability. Service or program improvement considers questions of program redesign to better satisfy existing objectives or to serve different program objectives.

Quality improvement systems require both routine and special studies of performance, measured against a broad array of program and policy objectives. The panel finds that certain features of comprehensive quality improvement systems are relevant to family assistance programs: quality improvement is driven by the analysis of performance data that measure the achievement of program objectives; quality improvement requires timely feedback, so that the responsible officials have the needed access to performance information; and quality improvement requires action that is consciously designed to improve performance and is monitored and assessed to ensure its effectiveness. These features apply to all levels in a service operation, from the point of delivery to the central office, although the studies, measures, and tools most useful for one level may differ from those most useful at or for another.

The panel finds that the AFDC and Medicaid QC systems lack many of the elements of a comprehensive quality improvement system. For process control and for planning process improvements, state and local managers require more performance data, at lower levels of aggregation, than are now provided through the QC system. The challenge of a quality improvement system is to create quality measures both within and across programs to improve coordination and overall performance and to identify what to fix at the micro and macro level to better achieve those objectives.

RECOMMENDATIONS: OVERVIEW

The panel recommends a number of changes that together will make the QC system a more effective tool for quality improvement. This section summarizes the panel's arguments and recommendations for a new quality improvement system; the next section details the recommendations. (A full discussion of the recommendations appears in Chapter 7.)

A Comprehensive System for Quality Improvement

Building the necessary capability for quality improvement at the state and local levels cannot begin until state quality improvement activities are freed from the federal financial monitoring function. The present two-tiered sample and review system hinders quality improvement, unnecessarily fosters conflicts among state and federal participants, and requires substantial commitment of resources that neither serve federal financial monitoring ideally nor permit states to use QC reviews to generate strategies for management improvement. Federal monitoring activities for payment accuracy should be separated from other state and federal quality improvement activities (Recommendation 1).*

Improving quality requires that performance measures reflect the achievement of all important program objectives. The performance measures to be used in quality improvement systems for the AFDC and Medicaid programs should reflect broadly the intent expressed in Titles IVA and XIX of the Social Security Act. In AFDC and Medicaid, achievement of program objectives frequently depends on factors beyond the boundaries of the Title IV-A agencies, and performance measures should reflect these factors. Measures of effectiveness, particulary those that might serve as performance standards to which states may be held financially accountable, should be assessed (Recommendation 2).*

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* A panel member dissents; see Appendix A.

The panel believes that the states need to develop their own quality improvement strategies, which should support process control and process and program design improvements. The federal government should provide assistance to the states in their efforts to develop evaluation strategies, obtain information on other states' experiences, and provide states access to technical assistance from federal as well as other experts (Recommendation 3).

In the transition from quality control to quality improvement, states should be required to spend as much money on quality improvement for 5 years as they did in 1987 on quality control. During the 5-year maintenance of fiscal effort, Congress should fund and closely monitor demonstration projects, and HHS should develop measures to expand the scope of performance standards* and report to Congress the results of its activities and its recommendations for appropriate levels of continued support (Recommendation 4).

Setting Performance Standards With Financial Consequences

The classic view of quality control is that performers should be held accountable to rules that are understood and agreed upon and for procedures over which they have control. Quality improvement systems should be designed to identify and attend to systemic problems in performance and to assign the responsibility for improving performance to the appropriate levels and managers within the AFDC and Medicaid delivery systems. Some problems may be national and must be solved at that level; others may be state or local.

In the classic view, a quality control system for a program operating within attainable levels of performance sanctions and rewards only those performers at the extremes of performance. In the face of demonstrated improvements in performance from fiscal 1980 through fiscal 1984, a QC system that finds almost all of its operating units to be performing poorly has one of two problems, or perhaps both: either the standards by which performance is judged are too stringent, or the QC system has failed to put in place the necessary quality improvement systems needed to achieve the standards within the prescribed time period.

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* A panel member dissents; see Appendix A.

The panel cannot set precise performance standards or magnitudes for sanctions and rewards tied to measures of achievement against those standards: they are policy choices; the empirical evidence necessary to frame them precisely is not available; and they should change over time to reflect changes in capability. The panel therefore offers Recommendations 5 through 9 as a whole, as the key elements appropriate to setting standards, which, when operating together, would *in their related effects* set the direction and magnitude of sanctions and rewards that the panel considers appropriate.

- The system should include rewards as well as sanctions that are calculated against benefit costs.
- Measures of performance to which financial consequences are attached should include criteria in addition to overpayments.
- Standards should reflect state-to-state differences in caseload composition.
- When states are operating at attainable levels of performance, thresholds for sanctions and rewards should be set so that only states at the extreme of good or bad performance are subject to rewards or sanctions.
- Special assistance should be given to the few states that remain poor performers.
- Federally approved state plans should provide the measurement standards against which to assess performance.
- Performance standards should change over time, to reflect changing performance capabilities.

The panel recommends that rewards as well as sanctions be established as a proportion of the benefit dollars in error above or below established performance standards. OFA and HCFA should monitor the consequences of sanctions, and Congress and

HHS should take steps to minimize potentially harmful effects of sanctions on program administration and program objectives (Recommendation 5).*

Exercising care in setting the magnitude of sanctions and monitoring state responses will help focus attention on poor performers, but equal attention ought to be paid to ensuring that meaningful corrective measures are developed and implemented. For states in special need of technical assistance, HHS should establish a special fund and support the necessary technical assistance, free of regional office constraints and using experts from both inside and outside the government (Recommendation 6).

Rewards for good performance and penalties for bad performance should be based on reliable measures of the achievement of desired objectives.

The panel recommends that HHS begin with measures of payment inaccuracy on which reliable measures are now widely available. HHS should estimate payment inaccuracy in the AFDC and Medicaid programs as a weighted average of four distinct payment error rates: payments to ineligible recipients, overpayments to eligible recipients, underpayments to eligible recipients, and payments that should have been made to applicants or recipients who were wrongly denied or terminated. The panel recognizes that policy makers may differentially value different kinds of payment errors. Such preferences can be represented by attaching numerical weights that correspond to the relative values of the different components of error, but the panel believes that each of the four types of error is important and should be reflected in the weights (Recommendation 7).*

Standards to which state officials are held accountable must be achievable. States should not be sanctioned for errors that are found on the basis of information not available during eligibility determination. Federally approved state plans for the AFDC and Medicaid programs should constitute the criteria against which states are evaluated. In essence, federally approved state plans should serve as contractual agreements between HHS and state agencies defining the procedures that state agencies will use and thereby providing the standards to which they will be held accountable. The panel further recommends that when Congress,

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* A panel member dissents; see Appendix A.

OFA, and HCFA make legislative and regulatory changes in the programs, states should be allowed time for implementing those changes before errors arising from them are counted for sanctions (Recommendation 8).

The panel recognizes that there exist features of state administration over which states have no control, and they should not be considered when determining state errors for financial accountability. Data show that there are consistent differences in error rates on several dimensions, particularly those related to cases with earnings or resources. OFA and HCFA should set performance standards for AFDC and for Medicaid, respectively, to reflect state-to-state differences in caseload composition with respect to groups that are differentially prone to error. Performance thresholds thus established should serve as action limits for sanctioning and rewarding states (Recommendation 9).

With the use of federally approved state plans as the standards against which the state agencies are to be held accountable, issues of policy interpretation will be taken up and resolved around the approval of state plans, not in disputes of case reviews for payment error. However, as long as the potential for regional HHS variation exists, a national office arbitration step is essential. Therefore, HHS should guarantee a process to accommodate state differences with federal findings of payment inaccuracies in AFDC and Medicaid and should establish procedures for the timely resolution of differences through the national office with respect to those findings (Recommendation 10).

Technical Considerations for Measurement and Reporting

In the current QC review and reporting process, both errors of measurement and selective sample attrition can occur. Either type of error can have serious effects on the estimates of payment error rates that are derived from QC reviews of sampled cases. The panel recommends that HHS rigorously assess the level of measurement errors and the degree of bias arising from failure to complete case reviews. This information should be used as a means of making continual process improvements (Recommendation 11).

While the use of samples in conducting reviews for monitoring purposes is well justified, the estimates derived from such samples contain room for error based on sampling alone. Sound statistical practice dictates that estimates of the sampling error be reported so that the users of the information can assess the risks of incorrect conclusions. HHS should routinely report estimates of sampling errors for all performance estimates based on sample data (Recommendation 12).

The panel also recommends that HHS design samples for the purpose of estimating payment inaccuracy rates to achieve equal precision across states. This recommendation is based on the recognition that the federal government needs to know how well each of the states is performing, but also that because of sampling error each state and the federal government face risks of incorrect rewards or sanctions due simply to sampling error. The federal government should expect each state to administer payments within the same margin of error and should apply penalties so that two states performing at comparable levels face similar risks of being penalized (Recommendation 13).

Clearing the Backlog of Past QC Sanctions

The panel believes strongly that it is essential that the backlog of pending QC-based liabilities be cleared as quickly as possible so that emphasis can be given to designing and developing quality improvement systems and creating an atmosphere in which these systems will have an opportunity to succeed. The panel recognizes that the changes recommended for the future cannot feasibly be applied to the past. Two other factors lead to the panel's recommendations for the backlog: the thresholds now governing the levying of sanctions are not empirically grounded, and the application of two-phase sampling in this QC program has been questioned on several grounds. With regard to the latter point, part of the debate revolves around the statistical tool used to merge the federal and state samples, part on uncertainties about the extent to which measured error rates are accurate. The panel has studied these questions further since its last report. Based on its further analyses and continuing concerns, the panel recommends a solution of expediency different from its recommendations for levying future sanctions and different from its last report: all state error rates for a given year and program should be combined into a single distribution of rates and only the extremely bad performers—or outliers—identified for sanctions. Technical issues concerning how to identify outliers are discussed in Chapter 7 (Recommendation 14).

DETAILED RECOMMENDATIONS

Recommendation 1: The federal sampling and measurement activities for monitoring payment accuracy in AFDC and Medicaid should be made independent of state quality improvement activities. Federal estimates for payment accuracy should be based on one federal review sample with one review of case records by federal QC reviewers, giving one estimate of state error rates.*

Recommendation 2: Payment accuracy and other measures of program quality should be set against broad program objectives, beginning with the language of intent in Titles IVA and XIX of the Social Security Act. Self-sufficiency and improved health status, although difficult to measure, are important broad objectives. These and other measures of program effectiveness, particularly those that might ultimately be used as performance standards, should be assessed.*

Recommendation 3: States should develop quality improvement systems. The federal government should strengthen the ways in which it helps states to develop and maintain those systems. It should provide technical expertise and financial and regulatory support to facilitate the design of process control tools and the rigorous evaluation of program and process design. OFA and HCFA activities should include randomized experiments with innovative practices and interagency cross-program effects. The federal government should disseminate the results of those studies; states should share information with other states.

Recommendation 4: (a) Congress should require that state welfare agencies for 5 years spend as much money (adjusted for inflation) on quality improvement as they did in 1987 on quality control. (b) Congress should separately authorize and fund demonstrations to support the transition from quality control to quality improvement and to ensure close scrutiny of state implementation. (c) During this 5-year period, HHS should develop standards for expanding the scope and specificity of quality improvement measures to which states can be held accountable.* (d) OFA and HCFA should report to Congress on the results of these activities and on evaluations of state efforts and recommend levels of support and other requirements for subsequent quality improvement activities at the end of the 5-year period.

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* A panel member dissents; see Appendix A.

Recommendation 5: Financial incentives should include rewards and penalties for measured performance. Rewards and penalties should be calculated as proportions of the federal benefit dollars at stake. OFA and HCFA should monitor the consequences of sanctions. Congress and HHS should take steps to minimize potentially harmful effects on program administration and program objectives, for example, by appropriate structuring of payment schedules for sanctions.*

Recommendation 6: HHS should establish a special fund to support technical assistance to states that experience serious performance problems in administering AFDC or Medicaid. Technical assistance should include help at sufficient levels from experts inside and outside of government and free from regional office constraints.

Recommendation 7: For purposes of financial accountability, HHS should estimate payment inaccuracy in the AFDC and Medicaid programs as a weighted average of four distinct payment error rates: (a) payments to ineligible recipients; (b) overpayments to eligible recipients; (c) underpayments to eligible recipients; and (d) payments that should have been made to applicants or recipients who were wrongly denied or terminated. Each of the four payment error rates should have as the denominator the total value of the payments actually made. The numerator should be the total value of errors for each component. The panel believes that each of the four types of error is important and should be accorded an appropriate weight.*

Recommendation 8: For financial accountability purposes, OFA- and HCFA-approved state plans for the AFDC and Medicaid programs should constitute the criteria against which states are evaluated. When Congress, OFA, and HCFA make legislative and regulatory changes in the programs, states should be allowed time for implementing those changes before errors arising from them are counted.

Recommendation 9: In order to take account of state-to-state differences in caseload composition, OFA and HCFA should set performance thresholds for AFDC and for Medicaid, respectively, for groups that are differentially prone to error. Thresholds applied to states should be adjusted to reflect those differences. OFA and HCFA should first examine the possibility of using at least three groups as likely candidates for such corrections at this time: all households with reported earnings, all nonearning households with one or more elderly recipient(s), and all other households.

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* A panel member dissents; see Appendix A.

Recommendation 10: Under the new system that the panel recommends, HHS should establish a process to accommodate state differences with federal findings of payment inaccuracies in AFDC and Medicaid and should establish procedures for the timely resolution of differences through the national office with respect to those findings.

Recommendation 11: As a means of making continual improvements toward reducing measurement error, federal agencies should rigorously and regularly assess the level of measurement errors as well as the degree of bias arising from failure to complete case reviews.

Recommendation 12: HHS should routinely report estimates of sampling errors for all performance estimates based on sample data.

Recommendation 13: HHS should design samples for the purpose of estimating payment inaccuracy rates to achieve equal precision across states.

Recommendation 14: HHS should eliminate as quickly as possible the backlog of sanctions to be applied. It should do so by combining the error rates for all states for a given year and program into a single distribution of rates and identifying for sanctions only those states whose error rates are extremely large—or outlying—in relation to that distribution. Determining the threshold for identifying extremely large error rates for any distribution of state error rates is a policy choice.

Acting Chairman **Downey**. We are in an odd position today. We have got two studies, one of them yours that says the system needs substantial change, and another by HHS that says that except for tinkering at the edges, all is well. I will throw this open to any member of the panel.

How do you reconcile the two, and who would you say is right?

Mr. **Neter**. The perspective that we have taken is one that does not accept as given the current system. We have asked what would be the best system, no matter how we got into the current situation. On the basis of that, we came to the conclusion that a major change in the system is required.

It is understandable that persons who are involved in the current system would be more reluctant to think about a drastic change in the system.

Acting Chairman **Downey**. As I understand it, the quality control system measures only one kind of performance, payment accuracy?

Mr. **Neter**. Yes.

Acting Chairman **Downey**. Your report discusses the need to expand the measures of quality that we use in the AFDC program. What are some of the other aspects of performance that we should measure?

Mr. **Neter**. We mention a number in our report, such as timeliness, or the effectiveness with which the people who are supposed to be reached are reached. There is a vast variety and one needs to examine these to find the ones that are most germane to your basic objectives and that can be measured reliably. We recommend, since it is not obvious which can be measured most reliably, that this 5-year transition period be used to examine additional measures.

But the main point is if you are really concerned about quality of these programs, you need to think of all the basic objectives that the programs are designed to achieve. Surely, those include more than payment accuracy.

Acting Chairman **Downey**. Did you want to add something to that?

Ms. **Kramer**. I was just going to add two issues. One of them is when you specify a performance standard that has serious consequences you need to be certain that measures against one objective still ensure that the program performs on other objectives that you also want. So there is first an interrelationship between objectives.

The second is that the welfare agencies, the IV-A agencies are asked to perform a rather broad set of tasks with a limited set of tools, and therefore they have an interdependency with a vast number of other agencies and activities. What you want to do is figure out ways to encourage them to coordinate effectively with these other agencies. That is a tough task. For a number of reasons the panel could not describe in detail how one does that. For employment standards, for instance, you do not want to develop measures that encourage for instance creaming of the easiest candidates just to reach a simple standard.

These are complicated questions and we suggest that you study them in detail. There are logical candidates for relationships, for instance, between the IV-A agency with a IV-D agency, or the IV-A agency with JTPA services or other economic development activities in the area. Those sorts of things are the kinds of thing you want to look at to be able to encourage the IV–A agency to perform toward intended so~~cial obje~~ctives.

Acting Chairman DOWNEY. How many of the recommendation you make can be implemented by administrative action and ho many of them would require legislation?

Mr. NETER. We have not made a detailed study, but clearly goodly number of our recommendations will require legislativ action.

Ms. O'BANNON. The first one dealing with the backlog, obviousl requires Congress to alter the threshold that it has set and look a the States as a whole continuum and determine each State in relation to the others, rather than the arbitrary threshold that sanctions virtually all of the States. And then select those States tha are the worst performers as compared against each other for th past. That will certainly require congressional action.

Acting Chairman DOWNEY. By 1993 the States will owe some $ billion in sanctions. You recommend that this money not be use for deficit reduction, is that correct?

Mr. NETER. We recommend that the entire system be viewed as quality improvement system, that the ultimate purpose is to improve quality as much as possible. All of the history in busines and other applications indicates that with that kind of focus, there is improved productivity and indeed savings.

Ms. O'BANNON. Congressman, could I just comment on that? was a State administrator for both the food stamp, Medicaid an AFDC programs in the Commonwealth of Pennsylvania from 197 to 1983. During that period of time, quality control and the use o those kinds of data were important to the Commonwealth and t our agency.

But as of 1979, when I first came into office, they were not use as a form of fiscal threat to the States. Rather they were used as partnership between the State and the Federal agency in order t help the State improve the performance in the delivery of the program.

Over the years, 1979 toward 1983 when I left office, it becam clear that the goal from the Federal agency administrators ha shifted to one of playing gotcha in an attempt to accrue to the Federal Government more and more of the resources, rather than partnership of trying to improve the administration and the overal joint accuracy and efficiency with which the programs were administered.

It is a real change in tempo, a real change in feeling. The imposition of fiscal sanctions, I think, brought that about.

Our other view from the standpoint of the panel is that a syste that finds virtually everyone, every participant, out of phase wit the standard has something wrong with it. Either the standard i too arbitrarily harsh or the way in which the standards are bein measured, performance is being measured, is incorrect.

Acting Chairman DOWNEY. Would you say that as a result of th greater emphasis on penalties that the system is worse now than i has been in the past?

Ms. O'BANNON. I cannot comment about whether it is worse o better, but it brings out some rather perverse behavior on the par of State agencies. For example, when you get cited repeatedly for a WIN registration error, you then go to blanket WIN registration. Everyone who signs a welfare eligibility form is automatically registered for WIN, so you will never be cited for a WIN registration error.

That has nothing to do with the effectiveness of referring the client to a WIN program to get her training and the educational resources needed to make her economically independent, which was the goal of the WIN program in the first place. But as a way of getting around the sanction, States conspire, in a sense, to beat the letter rather than to comply with the spirit of the legislation.

Acting Chairman Downey. Does this mean that you must practice defensive welfare administration?

Ms. O'Bannon. I think you have to.

Acting Chairman Downey. Is it more costly, in the long run, to do that?

Ms. O'Bannon. I do not think it is necessarily more costly but it certainly is not effective in terms of meeting the program objectives.

Acting Chairman Downey. Safe welfare practice is what we want to encourage. Congressman Matsui?

Mr. Matsui. Thank you, Mr. Chairman.

I would like to, first of all, thank the panel for their excellent report and recommendations. Professor Neter, just for the record, you are with the University of Georgia's College of Business Administration?

Mr. Neter. That is correct.

Mr. Matsui. How is your panel constituted? Obviously, it is a nonpartisan panel. Can you just explain, briefly, how the members came to be on the panel and how they were selected?

Mr. Neter. The panel was selected under the auspices of the Committee on National Statistics. I did not participate directly in the constitution of the committee. Perhaps, this may predate you, too?

Ms. Kramer. It predates me, as well. The general procedure is that the academy attempts to get a range of expertise on the question being addressed. In this case, there is a mix of statisticians and statistical people specifically involved in quality control and quality improvement activities, as well as a variety of individuals from welfare policy.

Mr. Matsui. Basically what I am saying is that not all of you are people who have administered welfare programs. Many of you seem to be in the academic world or are others who have no financial interest in this particular issue.

Mr. Neter. There were five or six statisticians on the panel. One was a former statistician in the Census Bureau with extensive experience in quality control. The others were academic statisticians. We had former administrators of welfare programs at the State level. We had people with responsibilities at the Federal level, including a former Undersecretary of HEW.

We had a variety of people who had participated in these programs, and others who had not.

Mr. Matsui. What we are really trying to do, and I guess the original purpose of the Michel legislation, was basically to make sure that we had good management in the area of administering these various Federal programs for low income people. Knowing the current law and knowing the potential impact of currently accrued and future sanctions can these sanctions legitimately be expected to improve management.

In other words, let me put it this way. If a state like Pennsylvania would be penalized from 1981 through 1984 in the range of $50 million, is that fair, in terms of your knowledge of statistics and in terms of the law that currently exists? In other words, does that have any relation with management?

Mr. NETER. Our panel stated, in its report, that these standards were basically arbitrary legislation and, in that sense, they may not have any relevance. They may or may not have any relevance to real capabilities and that is why we recommended for clearing the backlog that, since we could not go back and determine what the capabilities then were, that outlying States be identified with reference to the distribution of all States as they performed at the time.

Ms. O'BANNON. Could I comment on that, also?

Mr. MATSUI. Yes, please.

Ms. O'BANNON. I think that, to answer your question of the current system, the panel found that the current system was flawed. To have an effective quality assurance system, you need to know the rules ahead of time and you need to be held accountable for the rules ahead of time.

Under the current system of State review and a Federal re-review, what happens is because time passes, the Federal re-review may find information that was not available to the worker at the time that eligibility was taken and the individual was determined to be eligible. Nonetheless, that counts as an error.

It is a post hoc problem that the best management known today, given today's systems, could not change. But because it is a true error, prospectively we could improve, as States have done, the availability of wage match data and so forth, and the timeliness of it. So I think that is problem number one with the current system.

Problem number two with the current system is that, at least in AFDC, it counts technical errors. For example, the absence of the Social Security number. That has nothing to do, per se, with whether the check going to that woman and her two children was in the correct amount. But it is an error and the State is found to be in error because of the absence of a Social Security number. The Social Security number serves as a proxy for other program goals.

The third issue is because of the two-tiered system, there is a reliance on the regression estimator to combine the weights of the two samples, the State sample and the Federal sample. The panel spent a great deal of time discussing the value of the regression estimator.

The problem I think that we found with it, or a number of us found with it, is the regression estimator puts a great deal of weight on the Federal re-review. It says that in a sense the Federal re-review is the absolute truth. In fact, the Federal rereview is often more cursory, and is not as detailed as the State review which often requires home visits.

Second, the data combined in a regression estimator, should be linear and they should have a degree of normality. I am speaking as a statistician. I know virtually nothing about statistics except the education I have gotten in the 2 years on the panel. The problem, though, with the regression estimator is that it uses data that are nonlinear. So in a sense, it is somewhat flawed. It has some positive characteristics, but it also is flawed. So when you come up with an error rate of 8.4 percent using all of these things, and that error has attached to it a $50 million or a $30 million sanction, I think the Congress as well as the public, have to be very chary whether that really is talking about the adequacy of management or the reliance first on an arbitrary standard set by the Michel amendment and secondly on a rather arbitrary set of statistical artifacts and technical review and re-review findings.

Mr. Matsui. I will not get into the third part of your comment, but regarding the first two, there was a dissenting opinion in the record. In the dissent they raise the fact that replacing the two-tiered system with a single tiered system, as the NAS recommends, would cost more to the Federal Government because there would have to be more Federal regulators involved to monitor the system.

Is there any validity to that argument, and how would you respond to it?

Mr. Neter. Actually, in terms of the total cost, if you put the State and the Federal cost together, that portion of it would cost less because you would not need both the full sample and the subsample. Under our recommendation it would be done under the Federal aegis rather than under the State aegis. But if you look at the total cost of the system, that would not be true.

Ms. Kramer. I wanted to add two things. We have specifically said that you take this transition period to find out how much it will cost, so that you can make a reasoned judgment at the end of that.

The other thing refers to the meaning of two-tiered or one-tier. It is one-tier in the sense of one review system, but we are recommending two separate, complementary and parallel kinds of systems to produce different kinds of data and essentially feed and inform each other. I think that ought to be clear.

Mr. Matsui. The dissent States without explanation that counting technical errors serves a useful purpose. I, frankly, do not understand the dissent's position. Do you see any useful purpose at all of counting technical errors?

Mr. Neter. Yes, if you get away from Government programs and talk about business in general, when auditors come in and examine the operations of a company, they are interested in two kinds of errors, substantive errors and procedural or compliance errors.

Say in inventory control, there has to be some kind of authorization before someone can withdraw something from inventory. If that authorization is not a proper one, this is treated as a procedural or compliance error. That, by itself, does not mean that the withdrawal from inventory was improper. It is just that the procedures were not followed. But if the process is operating with the procedural errors in a very sloppy situation, that can very well lead then to substantive errors over the longer run.

So auditors will examine both substantive errors and procedural errors. In the same way, the quality improvement system ought to look at both. But a procedural error is not a substantive error.

In our report, we do mention that if procedural errors are defined in terms of procedures that really are effective for controlling quality, such as say a Social Security number that enables you to then make computer checks, that indeed one may then include procedural errors as part of this overall performance measure, giving them some weight other than say full errors, but in some way recognizing that they are important.

But they are a different kind of errors.

Ms. KRAMER. If I may add, the procedural error, as an internal control, ought to be used to control some kind of behavior that gets you to an effect in the end that is essentially substantive. What the panel is saying is the technical errors that are now used do not appear to be doing that very well.

My personal sense is there has been a problem created by the legal compliance with the work requirement and other eligibility requirements. And I think the agency people, when they speak to this question, will be clearer about it. It is created by a desire in the law to have the work requirement complied with and it is getting caught up in the question of whether you want to do that through the WIN registration requirement or some other way.

That is what you ought to be looking at to try to resolve the problem.

Mr. MATSUI. I would like to thank the three of you for participating today, and of course the entire panel for your two years of work. We really appreciate it.

Acting Chairman DOWNEY. Thank you. Mr. Brown?

Mr. BROWN. Can you give me an idea of the amount of penalties if the error rate where 6 percent rather than the 3 or 4 percent? Did you take a look at that?

Ms. O'BANNON. We did not look at that. I think that really, we believe, is a policy question for Congress, as to what level of error rate it wants to set, and what threshold historically, looking back.

Mr. BROWN. In your report, do you propose that Congress come up with a different threshold for imposing disallowances?

Mr. NETER. Are you speaking of the future, or clearing up the backlog?

Mr. BROWN. I am speaking of both.

Mr. NETER. For the backlog, our recommendation is that you group all the State error rates for a given year, for a given program. So say for AFDC for 1985 you have the distribution of State error rates. It will be a distribution with some very good performing States and then lots in the middle, and then there will be a few States with high error rates.

We recommend that you draw the line somewhere in this upper tail. In statistical practice, we would do something like 1 percent or 5 percent in the upper tail, but you may decide to draw it at a different point. That is largely a policy issue but you have the data so that you can determine how many States would be involved, and what the amounts would be.

Mr. BROWN. Your report includes that data?

Mr. NETER. We have some data, yes. Yes.

Ms. **Kramer**. The panel was insistent on not making a recommendation on where the line ought to be set, either for the past or the future. But it suggested to you a number of ways that you can make adjustments so that you can determine the desired result. You can choose the line anyplace you want, depending upon what result you want.

Mr. **Brown**. Let me get this straight. We asked for a study to take the heat off of us, to stick it on you, and your study ends up putting the heat back on us? Is that it?

Ms. **Kramer**. We did not think so.

Mr. **Brown**. We have got to get a panel that is more cooperative here.

Ms. **Kramer**. We thought we gave you some principles that were defensible in common quality control and based on scientific judgment. Using these you can move wherever you want, to achieve whatever policy objectives you want.

Mr. **Brown**. I am not going to fence with you, because I am obviously out-fenced, but let me ask you this. Is there some error rate that would suggest to you a lack of will, a lack of interest, in complying with the idea that errors should be held to a minimum? At what point can you say a State is not trying? Where does it turn over to simply a disregard of the rules?

Ms. **O'Bannon**. I am really speaking more from familiarity with the program than from the panel's perspective. What the panel says is that the rules should be understood ahead of time and that there ought to be, if you go forward and you adopt the recommendations that we set forth, account taken of the case composition in each State, that is going to vary from State to State.

We talk about households with earned income and households with assets, elderly people with assets, both of whom appear to present a higher proclivity for difficulty for the eligibility worker in accurately determining eligibility. A case changes a lot from week to week and month to month when the person has income.

Those cases, in a given State, will change. That composition will vary from State to State. If you then develop a set of error rates for all 50 States, using that kind of a rubric, you might want to look at States in comparison to each other against the same standard.

Mr. **Brown**. I understand that. You are now repeating what you said before. My question was a different one, though.

At what point do you say look, somebody really is not making an honest effort to live with these guidelines?

Ms. **O'Bannon**. I think when you see most of the States are able to reach a few threshold points. A few States are still the outliers. What the motivation is, whether they are unable or unwilling is something I cannot—and I do not think any one of us—can judge. But it is certainly something that they need help on.

They may need help in the form of both the fiscal sanction, as well as technical assistance.

Mr. **Neter**. Let me try to answer this in the context of business and industry. In general, the experience is that even if one thinks one has a good ongoing process, improvements can always be made. But there has to be the capability to identify when you are operating within the system and you are doing the best within the system you can but which may not be good enough.

But then one has to have the tools to redesign the system. And part of the problem is the complexity of these systems. Some of the tools arise out of legislative mandates, Federal restrictions, Federal regulations, and then you have State regulations. But if one had the flexibility to redesign systems to meet the objectives when the need exists, one in general can make substantial improvements in quality.

But the first focus, from the very top of the administration down, has to be on quality improvement. That is the lesson that we have learned from the Japanese and we are achieving that in industry where that effort is taking place.

Mr. BROWN. I guess I have asked a question nobody wants to answer.

Ms. KRAMER. Can I try a third time? It seems to me you can turn your question around the other way and say if the system is such that no matter how hard the States try they still cannot reach the standard, there is the point that you question whether you could be interfering with motivation.

The other part of the problem is that what we find in the current system is that given the information the system produces, the States cannot really know at this point what or where to make some fixes. That is the most important thing. I think that is what Dr. Neter is saying. The current system is not producing the kind of information that can push them yet further toward improvement.

Mr. BROWN. Thank you.

Acting Chairman DOWNEY. Don?

Mr. PEASE. Thank you, Mr. Chairman. Let me also thank the members of the panel. Obviously you have put a lot of time into this study and we think we will find it to be a valuable tool for us.

I think I picked up that you were talking about a 5-year study to put together this new quality control system?

Mr. NETER. We are talking about a 5-year transition period?

Mr. PEASE. What do we do during the transition period?

Mr. NETER. During the transition period, you shift to the new system. But going from one system to another cannot be done overnight. All kinds of changes in the system have to be made. So we are recommending a 5-year period to achieve this.

During this 5-year period, some additional things would be done, such as studies would be made of additional measures of quality that are important to the objectives, and these would be implemented during this period or by the end of the period.

But there has to be some transition period. You cannot just go from one system to another overnight.

Ms. KRAMER. I would add that the panel specifically says you should mandate that the States maintain their current efforts, but just do different things with the funds that they currently spend on quality improvements. It is not principally a study period, although it is in part a study period. But it is mostly aimed at starting immediately to operate a quality improvement system.

Ms. O'BANNON. Congressman, on day one of the new system of the first year in the 5-year process, I think the panel recognizes the Federal agencies could measure payment error rates provided they took into account overpayments, underpayments, payments to ineligibles and denial of payments and made it a more comprehensive system. And second, recognize the case composition differences to which I referred to before. That could be the very rudiments of a new, if you like, one-tier Federal review system that looked at payment accuracy as its first effort.

Obviously, as the year rolls along, with the help of studies, additional performance standards besides just payment accuracy, and additional thresholds, or a refinement of the thresholds, including refinement by case characteristics, whether using population density as the Senator mentioned and SMSAs or other refinements might be included in the overall system.

But there is a system that can be put in place on day one.

Mr. PEASE. You mentioned earlier and then again just now, that we need variable standards by States, depending on caseload, composition, and that sort of thing. Who is going to figure out what is the right standard for Ohio and what is the right standard for Washington and West Virginia and so on?

Mr. NETER. Our recommendation is to go part way. What I mean by that is, at one extreme you could not recognize any State differences at all. At the other extreme, you could have such a refined and complex model that tries to incorporate as many differences as possible, that it would be very difficult to implement and, in fact, that would be difficult to justify because one could come up with a competing model that gives somewhat different results and is not consistent.

What we are recommending is that you go someplace in between in a very simple fashion. When we looked at the errors that are produced in the current system, we found that most of them are related to income and to households with resources. There are distinct differences in the error rates for these three groups and States differ in terms of the composition of their caseload, with respect to these types of households.

The reason why we did not come out with a firm recommendation that those three groups be used is that our recommendations say you should not count technical errors. In the current system, the numbers that we have include technical errors. Our presumption is that you will find the same thing when these numbers are refined to reflect what we had recommended.

If so, you would have a very simple way of taking into account, at least in a partial way, major differences between caseloads. But for this to work, you have got to have major differences in error rates for these different groups, otherwise this does not make sense.

And second, you must have then major differences between States in the caseload composition which we know.

Mr. PEASE. Obviously, it is going to be in the interest of States to have as high an error rate number as possible, so that they are less likely to come in for penalties.

Does HHS negotiate that number with each of 50 different States? In the end, does HHS impose the regulations or is it subject to a satisfactory negotiation between the two?

Mr. NETER. Our recommendation is that national standards be set for each of these categories. In my example, these three case groups, national standards would be set for the error rate for each of the three groups. Then one takes the proportion of cases in each State for the three groups and calculates, in effect, a weighted average of the three standards. And that weighted average will differ for each state. But the standards are national standards.

Mr. **Pease**. That is very helpful. I am glad you clarified that for me.

Finally, I want to ask a question which I do not intend to be a flippant question at all, or one that reflects on your work. I know you have worked very hard and ably. But this sounds to me like it is going to wind up with a lot of complexity and a lot of argument. I guess I ask the question, have you considered whether we would be better off going back to pre-1980 and have no standards at all?

In other words, is the result you can reasonably expect to get worth the effort that you are going to have to put into it?

Mr. **Neter**. The committee considered the question whether there should be sanctions at all. And our conclusion was that sanctions properly used are an important component of a quality improvement system. A lot of the argument that is inherent in the current system arises because of interpretations of regulations. But the argument takes place in the context of deciding whether a particular sample item is in error or not depending on the interpretation of what should have been done, what the regulation's intent was.

What we are recommending is that the State plans be the standard against which states are to be held, and that those State plans be approved in advance. There will still be debates, but at least they will be done at the beginning. And then there is a contractual agreement, in effect, that States will be held to these standards. So we are recognizing there will still be differences, but they should be clarified and taken care of at the beginning rather than continuously as under the current system.

Mr. **Pease**. Very well. I think I have exceeded my time. I again thank you for your testimony, and we really do appreciate the hours and hours of work that went into this study.

Acting Chairman **Downey**. Bill?

Mr. **Frenzel**. I have no questions, Mr. Chairman. I thank the witnesses for excellent testimony and work.

Acting Chairman **Downey**. I want to thank the panel for its testimony and its report. Thank you very much.

The committee will next hear from the Department of Health and Human Services, Catherine Bertini, Director of the Office of Family Assistance, Family Support Administration.

Your statement, of course, will be included in its entirety in the record. If you would care to summarize, please feel free.

STATEMENT OF CATHERINE BERTINI, DIRECTOR, OFFICE OF FAMILY ASSISTANCE, FAMILY SUPPORT ADMINISTRATION, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES, ACCOMPANIED BY MACK STORRS, DIRECTOR OF QUALITY CONTROL STUDY, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Ms. **Bertini**. Thank you, Mr. Chairman, I would like to summarize my formal remarks. I would also like to introduce Mr. Mack Storrs, who is the director of the Department's QC study.

I am pleased to be here before you today to present the results of the quality control study of the Department of Health and Human Services. As you know, this study covers aid to families with dependent children and Medicaid. My comments will be primarily directed to the AFDC portion of the study. With your permission, I would like to submit my formal remarks as well as the executive summary of the report into the record.

Acting Chairman DOWNEY. Without objection, so ordered.

Ms. BERTINI. Congress asked that we study how best to operate a quality control program which will allow program managers to improve the quality of administration and to provide reasonable data on the basis of which Federal funding may be withheld for States with excessive levels of erroneous payments.

Our study substantiated the principle and the methods of the current quality control system. It also identified ways in which the current system could be improved to address future fiscal concerns as well as the rights of the program's recipients.

While we are committed to ensuring that individuals who need assistance receive what they are entitled to under the law, as Federal administrators, we have the additional responsibility of ensuring proper expenditures of Federal tax dollars. But without some State accountability for the erroneous expenditures of Federal dollars, we cannot meet our responsibilities to the Nation's taxpayers.

A viable QC system must take into consideration the shared roles and responsibilities of the State operational partner and the Federal oversight partner. With increasing emphasis on accountability, States achieved significant reductions in error rates through the use of QC findings. National AFDC payment error rates were reduced from 16.5 percent in 1973 to 6 percent in 1984.

Before the moratorium went into effect, the decreased error rate resulted in an avoidance of $860 million in erroneous expenditures by Federal and State Governments. Even so, actual erroneous expenditures in excess of statutory limits of Federal financial participation for the same period, which are represented by the pending disallowances exceeded $800 million in the AFDC program.

Since the October 1984 hearing that led up to the moratorium, error rates have increased in 29 States. Final data for fiscal year 1986 show a 25-percent increase in the national error rate over fiscal 1984. Erroneous overpayments grew to $1.1 billion in fiscal 1986.

We believe that this increase may be related to the moratorium on taking disallowances and a resultant lessening of State emphasis on error reduction.

These facts emphasize the success of the QC program and the need to keep it in place. Given the clear fiscal consequences, it is no surprise that there is significant State agency opposition to the current QC system. Criticisms of the system raised by its opponents are addressed in the HHS study.

I would now like to address a few more specific issues. A fundamental question concerning the QC system is whether it is effectively designed to accomplish its dual purpose. That is, can the audit function and the management improvement function best be served by the system currently in place, or by two separate systems?

We find no advantages to separate systems. In fact, to the contrary, there may be major disadvantages—increased cost, duplication of effort, and the loss of statistical precision. We estimate that establishing separate Federal and State systems that are as precise as the current system would, at a minimum, increase Federal cost by 50 percent per case, while State costs would remain the same or increase.

Additionally, separate systems provide no panacea for resolving the much discussed Federal-State conflicts over QC findings. As long as the potential loss of Federal funds is in the equation, differences between State and Federal findings are inevitable. The current two-tiered system provides an appropriate forum for resolving these differences.

A principal purpose of QC is to provide states with information to improve payment accuracy. Our survey found that States are using QC data in innovative ways for management purposes. Given the nature of Federal-State interaction and the need for individualized corrective action, we believe that the division between mandatory data collection and optional State supplementation of data, analytical techniques and corrective action is appropriate. System flexibility permits States to define and meet their own specialized needs. Therefore, the alternative—to expand the data collection requirements under a federally mandated QC system—is not only a less efficient way, but also a more costly way to approach corrective action.

Another area of concern was to determine whether the current QC system is too narrowly focused. The system focuses on the accuracy of determinations of eligibility and the amount of payment provided. We believe that the focus on payment accuracy is appropriate and should be maintained.

The QC system's focus on disallowances for erroneously spent funds is not meant to suggest that our only emphasis to improve program management should be through disallowances. In fact, there are a number of other performance measures designed for this purpose, and States have been aggressive about using them or employing additional ones.

Regarding adjustments to error rates for State-specific characteristics, States have recommended, and the Congress has considered, providing adjustments for certain caseload characteristics which allegedly influence the error rate, for instance, the existence of high unemployment rates. The Department report finds that while the concept of adjusting the error rate tolerances based on socioeconomic factors and case characteristics for individual States is appealing, neither our consultants nor those used by the Department of Agriculture could identify any equitable basis on which to make this adjustment.

In conclusion, we sincerely hope that we can continue the dialog with the States and the Congress that will enable us to meet your challenge of developing improvements to the current QC system. We are in the process of analyzing the National Academy of Sciences study and how it relates to our findings. After careful evaluation, the Secretary will act to incorporate any needed improvements in the system. We at HHS stand ready to continue to work with all interested parties to meet this challenge.

Mr. Chairman, members of the committee, I appreciate the opportunity to testify and would be glad to answer your questions.

[The statement of Catherine Bertini follows:]

STATEMENT OF CATHERINE BERTINI, DIRECTOR, OFFICE OF FAMILY ASSISTANCE, FAMILY SUPPORT ADMINISTRATION, DEPARTMENT OF HEALTH AND HUMAN SERVICES

Mr. Chairman and Members of the Subcommittee, I am pleased to appear before you today to present the results of the Department of Health and Human Services' study of the Quality Control system for Aid to Families with Dependent Children and Medicaid. Since this hearing is only addressing AFDC, I will direct my comments to those aspects of the study. I would like to briefly summarize our overview of the QC system and some of the major findings reached in the course of the Department's study. Then, with your permission, I will submit, for the hearing record, the Executive Summary of the report.

The Department conducted this study of the Quality Control -- or QC -- system at the direction of the Congress. The Congress asked that we study how best to operate a Quality Control program "which will allow program managers to improve the quality of administration" and to "provide reasonable data on the basis of which Federal funding may be withheld for States with excessive levels of erroneous payments."

The study was conducted by an inter-agency workgroup of employees of the Department under the guidance of a steering committee consisting of top level management executives from the Department and its operating components. To obtain expertise that was not available within the Department, as well as to provide an objective assessment of issues, we obtained the services of consultants. These included Harold Russell Associates, Westat, Inc., Kendrick and Company, and Macro Systems, Inc. Additionally, we sought public input through a Federal Register notice. Briefings and formal presentations were made to public interest groups with special interest in Quality Control. All concerns raised through this process were considered in the study.

We critically assessed the assumptions on which the QC system was built, researched pertinent issues, and explored viable alternatives and improvements to the current system. The study substantiated the principle and methods of the current Quality Control system. It also identified ways in which the current system could be improved to address future fiscal concerns as well as the rights of the programs' recipients. Some of the major findings are as follows:

1) The Quality Control system provides an adequate base of information for managers to improve administration and avoid erroneous payments.
2) The structure of the current system of a State review of local office eligibility determinations, substantiated by a separate Federal evaluation is appropriate for determining fiscal liabilities.
3) Given its current objectives, the Quality Control system is properly focussed.
4) A method for adjustment of tolerance levels for erroneous expenditures based on State-specific case characteristics and socio-economic factors, that would give fair and equitable treatment to all States, could not be identified.
5) The target population of the AFDC program should be protected from receiving too little in assistance and improper denial or termination, possibly by including such errors in the payment accuracy rate.

While we are committed to ensuring that individuals who need assistance receive what they are entitled to under the law, as Federal Administrators, we have the additional responsibility of ensuring proper expenditures of Federal tax dollars. But, without some State accountability for the erroneous expenditures of Federal dollars, we cannot meet our responsibilities to the nation's taxpayers. A viable QC system must take into consideration the shared roles and responsibilities of the State operational partner and the Federal oversight partner.

With increasing emphasis on accountability, States achieved significant reductions in error rates through the use of QC findings. National AFDC payment error rates were reduced from 16.5 percent in 1973 to 6.0 percent in 1985. In fact, for the five years (1981 - 1985) in which States were held accountable for erroneous expenditures, the decreased error rate resulted in the avoidance of $860 million in erroneous expenditures by Federal and State governments. Even so, actual erroneous expenditures in excess of statutory limits of Federal financial participation for this same period, which are represented by pending disallowances, exceeded $800 million in the AFDC program. Since the October, 1984 hearing that led up to the moratorium, 29 States' error rates have increased. Final data for FY 1986 show a [illegible] percent increase in the national error rate over FY 1984. Erroneous overpayments grew to $1.1 billion in FY 1986. We believe this increase may be related to the moratorium on taking disallowances and a resultant lessening of State emphasis on error reduction.

These facts emphasize the success of the QC program and the need to keep it in place. Given the clear fiscal consequences, it is no surprise that there is significant State agency opposition to the current QC system. Criticisms of the system raised by its opponents are addressed in the study.

I would now like to address more specific issues.

STRUCTURE OF THE QC SYSTEM

A fundamental question concerning the QC system is whether it is effectively designed to accomplish its dual purposes, that is, can the audit function and management improvement function best be served by the system currently in place or by two separate systems?

We find no advantages to separate systems. There may be disadvantages -- increased cost, duplication of effort, and loss of statistical precision. We estimate that establishing separate Federal and State systems that both measure State liability for error and are as precise as the current system would, at minimum, increase Federal costs by 50 percent per case, while State costs would remain the same or increase.

Additionally, separate systems provide no panacea for resolving the much discussed Federal-State conflicts over QC findings. As long as the potential loss of Federal funds is in the equation, differences between State and Federal findings are inevitable, and the current two-tiered system provides an appropriate forum for resolving these differences.

USEFULNESS OF QUALITY CONTROL INFORMATION

A principal purpose of QC is to provide States with information to improve payment accuracy. Our survey found that States are using QC data in innovative ways for management purposes. For example, States have identified:

1) Areas requiring special studies to provide in-depth causal data.
2) Policies and procedures requiring clarification, revision or additional staff training.
3) Methods of using State-only data to provide timely information for evaluation of the effectiveness of corrective actions.

Given the nature of Federal-State interaction and the need for individualized corrective actions, we believe that the division between mandatory data collection and operational State supplementation of data, analytical techniques, and corrective action is appropriate. System flexibility permits States to define and meet their own specialized needs. Therefore, the alternative to expand the data collection requirements under a federally mandated QC system is not only a less efficient way, but also a much more costly way, to approach corrective action.

FOCUS OF CURRENT SYSTEM

Another area of concern was to determine whether the current QC system is too narrowly focussed. The system focuses on the accuracy of determinations of eligibility and the amount of payment provided. We believe that the focus on payment accuracy is appropriate and should be maintained. However, our study did conclude that the scope of the QC system might be expanded to include all payment and eligibility determinations, including those which reduce, terminate, or deny aid to recipients.

The QC system's focus on disallowances for erroneously spent funds is not meant to suggest that our only emphasis to improve program management should be through disallowances. In fact, there are a number of other performance measures designed for this purpose and States have been aggressive about using them or employing additional ones.

ADJUSTMENTS TO ERROR RATES FOR STATE-SPECIFIC CHARACTERISTICS

States have recommended, and the Congress has considered, providing adjustments for certain caseload characteristics which allegedly influence the error rate (e.g., existence of high unemployment rates). The Department report finds that while the concept of adjusting of error rate tolerances based on socio-economic factors and case characteristics for individual States is appealing, neither our consultants, nor those used by the Department of Agriculture, could identify any equitable basis on which to make an adjustment.

UNDERPAYMENTS, TERMINATIONS, AND DENIALS

Our AFDC program already adequately protects recipients' rights by providing a readily available appeals process for recipients, or new applicants, who believe they have improperly underpaid, terminated, or denied assistance. The current QC system measures underpayment accuracy and the accuracy of case actions involving termination comparable to overpayments, because underpayments, terminations, and denials are not built into the financial disallowance process. We plan to conduct further research to determine the feasibility, and the methodology and resource requirements that would be necessary, to include these types of errors in assessing fiscal liability.

CONCLUSION

We sincerely hope that we can continue the dialogue with States and the Congress that will enable us to meet your challenge of developing improvements to the current QC system. We are in the process of analyzing the National Academy of Sciences' study and how it relates to our findings. After careful evaluation, the Secretary will act to incorporate any needed improvements to the system.

We all have a tremendous responsibility to the American public to ensure that domestic assistance programs operate efficiently and in the way Congress intended. The prospet of making changes to the technically complex QC system is a challenging one. We at HHS stand ready to continue to work with all interested parties to meet this challenge.

Mr. Chairman, Members of the Committee, I appreciate the opportunity to testify on this matter and would be pleased to answer any questions you may have.

Quality Control in AFDC and Medicaid

A Report to Congress

DEPARTMENT OF HEALTH & HUMAN SERVICES · USA

THE SECRETARY OF HEALTH AND HUMAN SERVICES
WASHINGTON, D.C. 20201

The Honorable George H. Bush
President of the Senate
Washington, D.C. 20510

The Honorable James C. Wright, Jr.
Speaker of the House of
Representatives
Washington, D.C. 20515

Dear Mr. President and Mr. Speaker:

Pursuant to Public Law 99-272, the Consolidated Omnibus Budget Reconciliation Act of 1985, I am submitting the Department's study of the quality control systems of the Aid to Families with Dependent Children (AFDC) and Medicaid programs.

Our study substantiates that the principles and methods of the current quality control systems for measuring payment errors in State public assistance programs are valid. Basically, the quality control systems efficiently and effectively provide information which will allow program managers to improve the quality of administration. At the same time the systems provide reasonable data on the basis of which Federal funding may be withheld for States with excessive levels of erroneous payments. However, the study raises several policy issues and suggests improvements to make these good systems even better.

After I have reviewed and analyzed the concurrent, independent report of the National Academy of Sciences, I will restructure the systems with the best features we can incorporate to achieve the dual, quality control purposes of management improvement and fiscal accountability.

Sincerely,

Otis R. Bowen, M.D.
Secretary

EXECUTIVE SUMMARY

A. PURPOSE OF THE STUDY

Section 12301 of the Consolidated Omnibus Budget Reconciliation Act of 1985, (Pub. L. 99-272) requires the Secretary of Health and Human Services (HHS) to conduct a study of the quality control (QC) systems of the Aid to Families with Dependent Children (AFDC) and Medicaid programs. The legislation also requires the Secretary to contract with the National Academy of Sciences for a concurrent, independent study of these systems.

Both studies are to examine "...how best to operate such systems in order to obtain information which will allow program managers to improve the quality of administration, and provide reasonable data on the basis of which Federal funding may be withheld for States with excessive levels of erroneous payments."

The studies were originally due to be reported to Congress one year after the date of enactment of the legislation. However, the Tax Reform Act of 1986 (Pub. L. 99-514) amended this provision to require that the studies be reported within one year after the Department contracts with the National Academy of Sciences for a simultaneous study. This contract was signed on September 30, 1986. The National Academy of Sciences later requested and was granted an extension of the contract for satisfactory completion of their report until December 31, 1987. The Consolidated Omnibus Budget Reconciliation Act also requires the Department to publish regulations revising or restructuring the quality control systems to the extent the Secretary determines to be warranted in light of these two studies by the end of March 1988 and to apply criteria for adjusting past disallowances as if the restructured systems had been in effect.

B. SUMMARY OF MAJOR CONCLUSIONS

The study substantiates that the principles and methods of the current quality control systems for measuring payment errors in State AFDC and Medicaid programs are valid and effective. However, the study concludes that improvements to certain aspects of the quality control systems could make good systems even better. The conclusions of each major study area are discussed in Section E of this summary. The body of the report gives extensive background information on each issue, exhaustively discusses options and the basis for the findings. A brief overview of the major conclusions follows:

-- The current double sampling, dual purpose quality control system provides an appropriate sharing of responsibilities and costs to efficiently achieve the management improvement and fiscal accountability purposes. However, when States have consistently achieved error rates below the threshold and disallowances or incentives are not in the balance, a more economical system of maintenance and selective Federal oversight should be used.

- The study concludes that there is no valid justification for excluding certain types of eligibility conditions, such as failure to register for the Work Incentive program, from error measurement. All errors which directly affect either eligibility or benefit amounts should be counted in the payment error rate.

- The QC system should demonstrate a fair, equitable and balanced concern and treatment of all payment accuracy errors, including underpayments, improper denials and incorrect terminations. If feasible after further study of measuring payment error rates for improper denials and terminations, this could be accomplished by combining these rates with the overpayment error rates and establishing a new absolute error threshold.

- To stimulate further error reduction and provide a balance to disallowances, fiscal incentives should be paid to States for outstanding payment accuracy performance.

- The QC system uses the point estimate of the payment error rate to compute incentives and disallowances. The study finds that this is the best and fairest method to all parties over time.

- The study finds that expenditures should be reduced by child support and third party liability collections which have been returned to the Federal government before calculating disallowances. However, since State reporting does not permit a breakdown of other types of overpayment recoveries, adjustment of these amounts could not presently be made.

The Department's study concludes that the basic quality control system is sound. The objective of quality control is to avoid errors. The moratorium on collections appears to have suggested to some State administrators that they need not be concerned with payment errors. AFDC erroneous overpayments exploded to $1.1 billion in fiscal year 1986, a $200 million, 25 percent increase over FY 1984. Collection of State liabilities should proceed quickly now that the moratorium is ending. Once States take error tolerances seriously, they will take the steps needed to improve their benefit systems. Collection of fiscal liabilities is an incentive States need to avoid errors.

C. BACKGROUND

The timely provision of benefits to needy individuals and families imposes complex administrative challenges, whether that assistance is AFDC money payments or medical care provided through Medicaid. At the same time, the growth and size of these programs demand strict fiscal accountability to the public. A critical responsibility of program oversight and administration is to ensure that those individuals who need assistance receive exactly what they are entitled to under the law. When individuals receive benefits for which they are not eligible or proper benefits are denied, resources are diverted from their intended purpose. Program equity, integrity and support is undermined and the very people the programs are intended to help are hurt. As a result, Congress, States and the Department have long been concerned with accountability and improved payment accuracy in the AFDC and Medicaid programs.

In response to these concerns, in the 1960's the Department developed quality control systems as an adaptation of a technique used widely in industry for evaluating and controlling the quality of products or services. Refined over the last two decades, the quality control systems represent a management improvement partnership of the States and Federal government to ensure program integrity and fiscal accountability. The QC systems use a statistical sample of cases to determine the types, causes and amounts of error, and analysis of these errors and other information to develop corrective actions or management improvements to reduce such errors.

A viable quality control system for the AFDC and Medicaid programs must take into consideration the shared responsibilities and roles of the State, an operational partner, and the Federal agency, an oversight partner. If a State improperly provides benefits, these erroneous payments result in a loss of both State and Federal funds. Yet, more than half of the cost of these programs is funded by the Federal government. In fairness Federal agencies should not be expected to share in the cost of program payments which are made in excess of reasonable limits, nor should States bear the full risk of error. Congress has defined the cost-sharing balance of error and explicitly limited the risk of the Federal government to statutory thresholds of erroneous payments, currently set at three percent. States bear the full risk of erroneous payments above these limits and can reduce their risk through improvements in payment accuracy, which is the ultimate goal. Thus, to stimulate optimum performance and balance the cost and risk of error, the quality control results are also used for the purpose of limiting Federal financial participation in erroneous expenditures.

With increased emphasis on accountability, States have achieved significant reductions in error rates through the use of quality control findings. AFDC payment error rates have been reduced from 16.5% in 1973 to 6.2% in 1985 and from 6.6% in 1978 for Medicaid to 2.7% in 1985. However, many States have persistent payment error rates in excess of the statutory thresholds, which make them potentially liable for large fiscal disallowances.

The study mandate required a re-examination of the methods to achieve both of the traditional purposes of the quality control systems in AFDC and Medicaid -- management improvement and fiscal accountability. The question of how to develop the most effective quality control system for management improvement and fiscal liability for erroneous expenditures is significant. Each percent of error results in hundreds of millions of dollars of misspent funds in a year. Given this consequence, it is not surprising that there are a wide variety of opinions about the current systems and issues to be addressed in the study.

We have taken the opportunity afforded by this study to critically assess these opinions, address pertinent issues and explore viable alternatives. Quality control systems should provide effective management information and a means by which the burden of erroneous payments can be shared in an equitable fashion between the State and Federal governments. We believe that the current structure of risk-sharing is basically fair, balanced and equitable. Improvements to the systems should be based on these same principles, maintain traditional areas of responsibility and be cost-effective to both levels of government. The study is designed to build on this balance and to meet not only the letter, but also the spirit of the Congressionally mandated objectives.

D. STUDY APPROACH

To meet the Congressional mandate, the Secretary established a Steering Committee to guide and direct the study effort and to coordinate activities between operational components, the Department of Agriculture and the National Academy of Sciences.

Chaired by the Assistant Secretary for Management and Budget, the committee included policy officials from the Health Care Financing Administration which is responsible for the Medicaid program, the Family Support Administration which oversees the AFDC program, the Office of the Assistant Secretary for Planning and Evaluation and representing the Department of Agriculture for the Food Stamp Program, the Assistant Secretary for Food and Consumer Services and officials from the Food and Nutrition Service. A Policy Advisory Committee and work group comprised of staff members from these Departmental organizations was responsible for carrying out the study and writing the report.

The following objectives were established at the outset for the study, recommendations and report:

- To provide a comprehensive analysis of the AFDC and Medicaid QC systems which address all potential issues;
- To ensure that States are held fiscally accountable for excess erroneous expenditures;
- To provide effective management information for corrective action;
- To produce a timely, quality report to Congress; and
- To assure consistency, where possible, between the AFDC, Medicaid and Food Stamp quality control systems.

The study was designed to provide: (1) an analysis of the developmental history of the quality control systems and current requirements; (2) an examination of previous research and studies regarding the systems; (3) an exploration of private sector quality control systems; (4) an assessment of a wide range of evaluations, critiques and suggested changes from interested parties; (5) original research and empirical data on select system features; and (6) a sound evaluation of the current system, alternatives and conclusions.

To facilitate the successful completion of the study, careful attention was made to obtain the broad input of those involved in AFDC or Medicaid quality control at all levels of administration. At the first meeting of the National Academy of Sciences' Panel on Quality Control, a variety of organizations and groups provided their written and verbal viewpoints on quality control which was shared with the Department. These included Congressional staff, the National Governor's Association, the American Public Welfare Association (APWA), welfare rights organizations and other interested parties. Presentations and meetings were held with the Quality Control Committee of the National Council of State Human Services Administrators, APWA and the National Association of Public Welfare QC Directors. Input was sought and received from all relevant Federal agencies, including particularly the Food and Nutrition Service of the U.S. Department of Agriculture which administers the Food Stamp program and the Department's Office of the Inspector General.

A Notice published January 23, 1987, in the Federal Register (Volume 52, No. 15) sought public input for consideration in the study. Twenty-two comments were received from States, counties, and interested organizations. All concerns raised and recommendations offered were considered in the relevant portions of the study.

To acquire expertise which was not available within the Department, the services of consultants were obtained through four major research contracts.

E. ISSUES

The following is a brief summary of the findings and conclusions about the major issues included in the study:

WHAT ARE APPROPRIATE STATE AND FEDERAL ROLES TO ACHIEVE THE DUAL PURPOSES OF QUALITY CONTROL?

A fundamental question concerning any system is whether it is effectively organized to accomplish its objectives. In the current "two-tier" QC system, States first review a statistically reliable sample of cases to determine payment accuracy and then the Federal government conducts a re-review of a subsample of these same cases to validate State findings. The official error rate is determined based on the combined findings of these reviews. The results are used for the dual purposes of providing State management with information to reduce errors as well as providing the Federal agency with an audit instrument for assuring fiscal accountability.

Critics of this approach argue that the dual purposes are incompatible in a single system. States contend that using the information for fiscal disallowances discourages the self-identification of errors and maintain that it is inappropriate to use State staff to perform what is considered to be a Federal audit function of calculating disallowances.

An alternative approach has been proposed which separates, by purpose, the functions and responsibilities between the States and Federal agencies -- a Federal system for determining disallowances and a separate State designed system for management improvement. However, it is likely that as long as incentives or disallowances are in the equation, conflict between States and the Federal government is inevitable, whether under separate systems or a joint Federal/State system.

The major impact of separate systems relates to cost, efficiency and statistical precision. Separate systems would greatly increase Federal cost. For example, preliminary estimates indicate a seven-fold increase in Federal QC staff would be required to complete the size samples currently used by States. Existing resources would permit an annual sample of only around 11,000 AFDC cases and 6,500 Medicaid cases which would result in a significant loss in the precision of the error rate for determining disallowances and heighten concerns about validity.

With separate systems, States would need to dedicate comparable resources to a new management improvement system to compensate for lost information or be totally dependent on the Federal system. It is unlikely States would opt for the latter, therefore negating any State staff savings.

Based on a study of this issue conducted by Harold Russell Associates, the Department finds no significant advantages to separate audit and management improvement systems.

ARE QC DATA ADEQUATE FOR MANAGEMENT IMPROVEMENT?

One of the principle reasons for the QC system is to provide States with information on the frequency, magnitude and sources of error to guide improvement in payment accuracy. From each review, a State derives detailed information about the case, persons in the household and their earnings and resources, each element of eligibility and detailed error findings. Critics have charged that this information is not sufficient for use in corrective action planning. While the QC system provides a wealth of valuable data, it was never intended to be the sole source of information about errors and the system itself is designed to be only one tool for effective program management.

Under contract to HHS, Macro Systems, Inc., studied the adequacy of QC data for management improvement. The basic findings were:

- Data collection methods are adequate to provide useful data for management improvement.
- While QC data do not provide all information necessary for corrective action and are limited with respect to locally specific information, the system provides sufficient flexibility to meet specialized State needs and has resulted in a variety of innovative systems for data gathering and analysis to supplement QC data.
- The threat of disallowances may hinder recognition of the usefulness of the data for management improvement.

Macro concluded that State arguments condemning the usefulness of QC data for management purposes are not supported by the ways and extent to which the data are actually used.

IS QUALITY CONTROL COST-EFFECTIVE?

Since the purpose of a QC system is to reduce erroneous expenditures, thereby reducing costs, it is reasonable to examine whether the system leads to net cost avoidance. Between 1980 and 1985, the QC error rates have been reduced from 7.8 percent to 6.2 percent for AFDC and from 5.1 percent to 2.7 percent for

Medicaid. Gross measures of savings and improvements can be estimated by comparing the error rate reduction amounts with the cost of the QC review. Assuming the AFDC 1985 State QC cost is representative of the annual cost during the 5 years 1981-85, the avoidance of $398 million in State expenditures at a State QC cost of $60 million resulted in a return of more than $6 for $1. Similarly in Medicaid, States have avoided $1.3 billion at a State cost of $50 million for a return of $26 for $1.

Clearly the rate of return to the State is less than shown above since the costs of corrective action are not included. Costs of major corrective actions, such as monthly reporting systems or expanded computer capability will reduce this cost/savings ratio somewhat, although these costs are not reported in such a way that they can be isolated for computation purpose. However, analyses of total administrative costs shows no overall relationship between these costs and error rates, suggesting that States may be able to effectively allocate resources to prevent errors without increasing the administrative costs per case. Finally, a 1984 study conducted by Touche Ross and Co. supports the contention that corrective action continues to be cost-effective, even when error rates are alleged to be approaching levels of diminishing returns. It was found that there were a variety of effective, low-cost corrective actions which had not been implemented by a number of States.

SHOULD QC INCLUDE BROADER MEASURES OF PERFORMANCE?

Critics of the current QC system contend that the focus on the correctness of benefits leads to neglect of performance in other important areas, such as timeliness and quality of service delivery. However, this contention is based on the faulty assumption that no other management information systems exist. In fact, a wide variety of standards and State and Federal performance reporting and measurement systems provide additional indicators of quality, efficiency and effectiveness for many program goals and objectives. For example, at the Federal level, the periodic "Profile of State Performance" monitors AFDC performance and reports on quality, efficiency and accuracy. States can use this information to compare their performance to other States and to national averages.

QC was never intended to be the sole measure of program performance nor the sole source of information for management improvement. The major difference between erroneous expenditures and other measures is that QC involves fiscal disallowances for States with poor performance. However, Macro Systems, Inc. found that while States wish to have good performance in other areas included in any incentive system, they are very much opposed to counting other measures in any disallowance system. Federal agencies encourage and support State efforts to expand the measurement of major aspects of program performance and develop quality improvement activities.

SHOULD QC COUNT AS ERRORS THE FAILURE TO MEET ALL STATUTORY ELIGIBILITY CONDITIONS?

A source of continuing debate is the extent to which States should be held accountable for all types of errors. Some eligibility conditions can be met by the signing and/or filing of a form and thus, failure to meet these conditions can be easily corrected. Some view these errors as merely procedural omissions unrelated to the correctness of the payment. Correcting the omission, it is contended, does not alter the amount of the payment made or result in any "real" savings. These errors include failure to secure or apply for a Social Security number, failure to register for the Work Incentive (WIN) program, failure to assign child support rights, failure to assign rights to third party payments, and failure to obtain monthly reports from cases for which they are required.

Currently, all errors are counted in computing the AFDC error rate, but the so-called "technical errors" are excluded by statute from the Medicaid error rate. "Technical errors" are statutory requirements for recipients, some of which lead to penalties for recipients who do not comply with them. Since recipients may be penalized for non-compliance and as statutory requirements, it seems only fair for them to be counted as QC errors. Failing to hold States accountable for them is a disincentive to their enforcement. Additionally, these conditions of eligibility are designed to improve verification capability or to reduce the need for assistance and thus, if enforced, might result in savings. Finally, these errors are totally within the agency's control and are most amenable to corrective action. The study concludes that there is no valid justification for excluding certain types of basic eligibility conditions from the error measurement.

TO WHAT EXTENT SHOULD STATES BE HELD ACCOUNTABLE FOR CLIENT ERRORS?

In counting errors for error rate calculation and disallowance purposes, no distinction is made as to whether the error was caused by the agency's failure to discharge its responsibility in a proper and timely manner (agency error) or by the client's failure to give correct information or otherwise discharge his/her responsibilities (client error). States contend it is unfair to hold them fully responsible for client errors because these errors are difficult to control.

Experience shows that States can do and are doing much to reduce and control client error. To the extent that these errors are "uncontrollable," it can be argued that the Congress recognized this and that the three (3) percent error tolerance provides for this. Determining whether an error was caused by the agency or by the client is subjective -- i.e., did the client fail to report information or did the agency fail to ask for it? This delineation for disallowance purposes would give rise to another area of contention between State and Federal governments and would tend to move the focus from preventing the error itself to determining who caused the error. However, proper identification of error cause is important for corrective action purposes. For these reasons, we conclude that client errors should be counted.

HOW SHOULD UNDERPAYMENTS, IMPROPER DENIALS AND INCORRECT TERMINATIONS BE TREATED IN QUALITY CONTROL?

Often the term erroneous payment is used to describe only an overpayment or payment to an ineligible case because those are the errors currently subject to statutory error tolerance limits and disallowances. However, underpayments, improper denials and incorrect terminations of assistance to eligible individuals are no less erroneous. Welfare advocacy groups have contended that the concentration on reducing overpayments and payments to ineligibles to avoid disallowances foster these other errors.

Our analysis does not indicate that States have concentrated their efforts on reducing overpayments at the expense of underpayments and nonpayments; to the contrary, comparison of the error rates suggest that corrective actions have often reduced all types of payment errors. Nevertheless, the current system does not provide comparable treatment of the underpayments and nonpayments which most directly affect applicants and recipients. To avoid even the appearance that QC concentrates only on overpayment, we have concluded that the system must demonstrate a fair, equitable and balanced concern and treatment of all payment accuracy errors. Action to hold States accountable based on error rates must include all errors -- payments to ineligibles, overpayments, underpayments and denial and terminations of assistance to eligible individuals.

However, further research is needed to determine the feasibility, methodology and resource requirements of an expanded system to determine payment error rates for improper denials and terminations (negative case actions) before these rates are used for purposes of fiscal liability.

ARE MANAGEMENT CONTROLS ADEQUATE TO ENSURE CONSISTENT AND TIMELY QUALITY CONTROL DATA?

States have often expressed the desire for greater uniformity and consistency between the program and QC policies of the AFDC, Medicaid and Food Stamp programs. We are in agreement that policy differences between programs may be one contributory source of error. To the extent feasible within different statutes, the Department is committed to the principle and the ongoing process of reducing program differences. Since the agencies are limited by the statutory framework, substantial simplification and uniformity can only be achieved by a concerted effort of the cognizant Congressional committees.

Some States also maintain that the Federal management controls designed to achieve consistent and comparable error rates are inadequate. We are satisfied that the existing controls are adequate to assure consistent and timely reviews and data. The system addresses the goal of consistency by standardizing acceptable sources of evidence of payment errors; by improved communication between States and Federal agencies; by calculating error rates using the regression methodology, which assures uniform application of QC error definitions between and among States; and by central office oversight of Federal regional reviewers. Timeliness of data for corrective action has been improved with the micro computers that the Federal government has provided States so that they can have constant access to information used to calculate error rates. Time requirements for Federal and State action during the QC process also have speeded up the collection of data and subsequent calculation of the official error rates.

ARE THE SAMPLING PROCEDURES VALID?

To provide a reliable basis for the measurement of QC error rates, Federal instructions outline sample design, composition, selection and size requirements that States must follow. The study concludes that these prescribed procedures for drawing the State samples are standard applications of valid and widely used sampling methods and management controls. In addition, Federal oversight steps taken by regional staff ensure consistent and uniform application of the valid sampling procedures.

DOES THE REGRESSION METHODOLOGY PRODUCE ACCURATE AND UNBIASED PAYMENT ERROR RATES?

The objective of the Federal re-review process is to ensure that State payment error rates are accurate. The procedure used in Medicaid and AFDC to ensure that State payment error rates are valid is the regression estimator with double sampling method. The estimator makes use of the results available from the full QC sample for a State together with those for the Federal subsample. The procedure provides an estimate of what would result if the Federal review, preceded by a State review, were applied to the entire caseload.

Some critics contend that the double sampling process and regression methodology are inappropriate and invalid. They argue that the statistical methodology or regression estimator is biased, overstates error rates and fails to produce a reliable or adequately precise basis for disallowances.

Since 1973, several independent consultants have assessed the regression methodology. The Gallup organization found that the use of the regression method to estimate the proportion of errors in eligibility and payments is statistically unassailable. Other statistical experts have been consulted on some of the more technical issues and have reaffirmed that the regression estimator is a consistent and only trivially biased estimator of payment errors.

For the current study, Westat, Inc. used actual State and Federal data to simulate large numbers of independent samples for three different populations. On the basis of these simulations and their analysis, Westat concluded:

- The regression methodology provides unbiased or, at the most, trivially biased point estimates of the payment error rates for the AFDC QC samples in use.

- The sampling errors estimated from the sample also provide, on the average, nearly unbiased estimates of the sampling errors of these estimated payment error rates. However, they are subject to large sampling errors.

- The confidence intervals as now being computed yield results that, although moderately skewed, nevertheless provide useful guides to the precision of the point estimates of the payment error rates.

- The point estimates are not affected by the imperfections in the computed confidence intervals. They provide estimates of the payment error rates that are valid within the ranges of error indicated approximately by the computed confidence limits.

Based on these findings, the study concludes that the regression methodology is satisfactory for producing statistically valid and nearly unbiased estimates of payment error rates.

HOW PRECISE ARE THE PAYMENT ERROR RATES?

Precision is the degree to which a sample estimate, or error rate, approximates the true value of error in a population. Precision provides a measure of the risk to the States and Federal government that the calculated fiscal liability is different from what would be determined if the true rate were known. All things being equal, one would want the best precision obtainable to use estimates for disallowances. Generally, the smaller the sample size, the greater the variability of the error dollars in the sample and the wider the confidence interval of the point estimate. Current QC sample sizes produce relatively large and varying sampling errors. States contend that current estimates are too imprecise for fiscal consequences and some have suggested the need for equal precision across all States.

Setting sample sizes to produce a specified magnitude of equal precision across States would be difficult to achieve because of the volatility of the standard error estimates. Using past data to determine sample sizes does not ensure that equal precision would be achieved. Even if it could be achieved, it would not be appropriate. In California, for example, the cost of AFDC assistance payments in FY 1985 was $3.4 billion while in Wyoming it was about $14 million. It would be far too costly to take a large sample in Wyoming and significant losses would be risked if a small sample were used in California. Given the far different impact on potential erroneous expenditures, it would not be cost-effective to use similar sample sizes in these two States.

Better precision may be obtained primarily either by increasing the sample size or appropriately stratifying the sample. However, any improvement in precision must be viewed in terms of the additional costs involved. For those States that wish to increase their samples above required sample size, Federal matching for the additional costs involved are made available. None of the States increased their 1985 samples above the required standard size to improve the error rate precision. On the other hand, nine States chose to reduce their AFDC QC samples. HCFA has encouraged, but not required, States to use stratification methodologies to improve precision. Only a few States have done so. While stratification provides worthwhile gains in precision for Medicaid, it will be less effective for AFDC.

Nevertheless, States have argued that point estimates are not a sufficiently reliable basis on which to make disallowance decisions. Since the unavoidable risk of sampling error is equally shared, we have concluded that it is within the State's power to improve the "reliability" factor if they choose, and thus no system changes are needed.

WHAT METHOD SHOULD BE USED TO CALCULATE DISALLOWANCES?

Current policy in AFDC and Medicaid uses the point estimate of the payment error rate for determining a State's disallowance. A State with an error rate exceeding the statutory tolerance has its liability computed on the basis of the difference between its point estimate and the tolerance. Since the payment error rates are based on sample estimates, States contend that the true error rate could be anywhere within the confidence range. They argue that the lower bound of the confidence interval should be used to guarantee that an improper liability is not calculated. While the true error rate may be below the point estimate, it is equally probable that the true error rate could be above the point estimate. When this is so, the liability is understated and the Federal agencies absorb the loss.

The study examined seven possible methods for calculating disallowances. While statistical considerations are involved, the decision is clearly a policy choice. There are no empirical or right or wrong solutions. Since there are precedents for each approach, one's choice is ultimately a preference based on desired goals or outcomes.

Use of the point estimate for calculating both disallowances and any incentives which might be added to the program is the best and fairest method to all parties over time. It is ordinarily and appropriately used when a sample estimate is used to allocate a payment amount between two parties. Given some unavoidable level of sampling error in the estimated State error rate, some risk always exists that the disallowance or incentive will be different from what would be determined if the true error rate were known. Fairness dictates that the risk be shared equally. Given the current partnership responsibilities of the States and Federal agencies to carry out the complex and critical AFDC and Medicaid programs, we believe that the current point estimate policy should be maintained.

WHAT SHOULD BE THE ERROR THRESHOLD?

The issues of how and at what level to establish the error threshold are of critical importance because the choice affects payment accuracy priorities and the limit on the amount of erroneous expenditures for which Federal matching is available. Critics of the statutory, national threshold levels argue explicitly that standards which result in disallowances for many States are too stringent and will limit the ability of States to effectively manage their programs. Some suggest an empirically based national level which most States could achieve or error rate adjustments for good performance in other areas. Others suggest separate thresholds for each State based on their individual performance capabilities.

While the error tolerance can be established in a variety of ways, the decision as to what is the "right" level cannot be empirically determined. Choice of an appropriate level should reflect consideration of what are reasonable amounts of error in terms of the public interest, the probable cost/benefit of error reduction and recognition of the inherent difficulties of preventing all errors. Ultimately, both the method and the level reflect a policy choice based on preferred outcomes. The Department is convinced that past error reduction progress is directly attributable to stringent tolerances. More States are meeting the error threshold each year and the potential for further improvement exists. Thus, we believe the current three percent tolerance appropriately emphasizes payment accuracy and fiscal accountability while recognizing an acceptable level of error funding.

SHOULD THE ERROR THRESHOLD BE ADJUSTED FOR VARIATIONS IN STATE CIRCUMSTANCES?

This issue has been one of the most-discussed areas of controversy relating to the QC system. States maintain that a single national error standard ignores marked difference among the States in demographic, socioeconomic and programmatic factors. They maintain that these, so-called "uncontrollable" factors, have a substantial impact on error rates, and that some system should be developed to compensate for these differences.

The Department began researching this possibility in 1978, with a study which found several socioeconomic factors and case types statistically associated with higher than average error, and several administrative procedures which effectively limited incorrect payments. However, the explanatory power of these measured variables was limited, explaining less than 10 percent of the variation in error. This means that the findings left 90 percent of the variation in error unexplained, and the Department concluded that adjustment of the threshold on that basis was unjustified. Other research has produced similar results.

Debate has continued, however. Specifically, States contend that factors such as payment of AFDC to children of unemployed parents, population density that exceeds the national average and a higher-than-average proportion of cases with earned income cause higher error rates, and thresholds should be adjusted accordingly. Legislation was introduced by Congressman Robert Matsui of California to make these adjustments. Other factors alleged as having a significant relationship to higher error rates include education level, crime rate, and agency caseload size.

As part of this study, the Department contracted with a statistical consulting firm, Kendrick and Company, to examine the issue. Using previous research as a point of departure, the study sought to examine analytically the influence on States of the so-called uncontrollable variables and to develop a mathematical model which could be used to adjust the tolerance level to compensate for the influence of these factors.

QC case review information and findings were used in conjunction with census data and official error rate data to develop and test three regression models. The results can be summarized as follows. None of the three models lend themselves to the fair and equitable adjustment of error thresholds for which they were designed. Either they violate logical sense or they are sensitive to the arbitrary selection of variables. While there are socioeconomic factors and case characteristics which are statistically associated with error, models developed using these variables fail to pass established acceptance criteria due to excessive collinearity and biased coefficients. Based on the low correlations or explanatory power of the variables, which are apparently intrinsic to these data, there appears to be no way to avoid the effects of these problems. In short, under one model a State's disallowance may drop substantially, but under another model using different factors of similar information content, that same State's disallowance may actually rise.

Therefore, although the concept of threshold adjustments for statistically significant socioeconomic or case characteristic variables is logically appealing, the research simply provides no empirical or objective basis on which to select variables to make these adjustments. Based on the results of this analysis, adjustments should not be made based on models examined to date nor on any adjustment formula for which variables are arbitrarily selected.

SHOULD INCENTIVES BE PROVIDED FOR OUTSTANDING PERFORMANCE?

From 1978 to 1983, fiscal incentives were awarded to States with low error rates in the AFDC program by statute. There has never been any fiscal incentive legislation in the Medicaid program. Incentive are currently provided under the Food Stamp QC system. Arguments have been made that the AFDC and Medicaid systems are unbalanced. In fairness, any system of disallowances should have its counterpoint in rewards for good performance.

In principle, the Department is in complete agreement that there should be positive financial rewards or incentives for outstanding performance. Incentives should provide public recognition for payment accuracy excellence in all error rates and stimulate further error reduction. Various options provide substantial policy choices in determining how and under what conditions incentives should be paid. To be effective it should (1) be attainable, (2) be large enough to provide motivation, (3) promote reduction of all errors, including underpayment and nonpayment, (4) be reserved for outstanding performance, and (5) never exceed the savings resulting from the improved performance.

SHOULD STATES BE CREDITED FOR RECOVERIES?

States argue that the Federal government should not assess disallowances on that portion of funding for which recoveries have been made and returned. This arises primarily in relation to child support collections, third party (medical) liability, and overpayment recoupment. We agree in principle that disallowances should not be taken for funds that have been recovered.

For recovered child support and third party liability payments, it would be possible to deduct all such reimbursements from the total expenditures before disallowances are calculated. Since these recoveries are made across the caseload and irrespective of whether the case happens to turn up in a QC sample, this would be the simplest, most easily understood, non-controversial method for crediting States for collections/recoveries returned to the Federal agency. Such adjustment should be made. In fact, it is being made now in Medicaid for third party liability collections.

On the other hand, recoupment of overpayments are recoveries specific to error cases. Recovery is generally made through adjusting the grant for future payments, thereby automatically reducing the total expenditure base (on which disallowances are calculated) to account for overpayment recoveries. Cash recoveries are rare, and cannot be distinguished from overpayment recoveries for types of cases excluded from quality control such as emergency assistance or insurance settlements. Thus, adjustments to compensate for overpayment recoveries before computing disallowances cannot currently be made.

F. NEXT STEPS

The Department has concluded that the current AFDC and Medicaid quality control systems have basically been effective in reducing erroneous payments, balancing fiscal accountability and enhancing program integrity. In order to see how a good process might be made even better, we propose to take the following course of action.

- Continue operating the AFDC and Medicaid QC systems under current law.

- Review and analyze the National Academy of Sciences' report and recommendations.
- As determined warranted, develop appropriate regulatory changes or legislative proposals to restructure existing systems.
- Meet with representatives of Congress to provide further background to our conclusions and statements of principles.

We believe that this is the course of action which provides a proper balance to the continued execution of past and ongoing responsibilities with the opportunity to make necessary changes which improve the management and integrity of these programs.

Acting Chairman DOWNEY. Thank you for your testimony. You have done a study. The Academy has done a study. Let me put to you the same question I put to them. They say the system needs to be completely overhauled and you say it just needs some changes at the margin. You further testify that you are going to analyze, take a look at what they have said and try and incorporate it.

What does that mean? Does that mean that your study is not complete and that there is something to be learned from the Academy of National Sciences?

Ms. BERTINI. Since the Congress in its wisdom asked both of us to do a study, we did not want to be so presumptuous to say that everything that we have to say is exactly, totally correct, though we certainly think that we are going in the right direction. We do support our study's conclusion. We do think it is a good study. But we also want to leave open the option to review the Academy's report, before the Secretary takes a final position and actually make recommendations for changing the system.

Acting Chairman DOWNEY. When will your final recommendations be made to us for changing the system?

Ms. BERTINI. Basically, our Department's recommendations through this report is as it is presented to you today. I believe the way the statute reads, we are both to do our own study, make our recommendations, which both have done, and then the Secretary will review both and act within a 6-month period.

Acting Chairman DOWNEY. Is there something wrong with a system that says that 9 out of 10 States, 90 percent of the States, are doing something wrong? I mean, just on its face, is that not ridiculous?

Ms. BERTINI. The reason why we do not think that is true, Mr. Downey, is because the States have moved, up until 1984, in the direction of decreasing error rates dramatically, as I testified, from 16.5 to 6 in 1984. And we believe that that direction is a result of many different factors, but the major one is the direction by Congress to decrease error rates systematically down to what is now a 3-percent tolerance and to do that within the current structure. As I mentioned, until 1984, there has been a decrease, so we think that the targets and the direction are proper.

Acting Chairman DOWNEY. So it is acceptable then to have 45 States in the union not be in compliance with the law? Yes or no.

Ms. BERTINI. Yes.

Acting Chairman DOWNEY. Do you believe the statement that the moratorium has caused the States' overpayment error rate to increase? Do you really believe that? You testified—and I do not want to misstate what you have said—that overpayments increased to $1.1 billion in 1986. You suggested that this might be the result of decreased State efforts to reduce overpayments which might have been caused by the moratorium on the recovery of the Federal share of these costs.

Ms. BERTINI. We believe, as the Academy has also stated, that the disallowances are an important part of the process.

Acting Chairman DOWNEY. Disallowances are one thing. But that the moratorium is affecting overpayments, that is something else.

Ms. Bertini. The moratorium and the thought on the part of the States that the disallowances may not be enacted, yes, we believe is potentially one of the factors.

Acting Chairman Downey. Since the State is paying 45 percent of the benefit, does it not have some incentive on its own not to overpay?

Ms. Bertini. Yes, the State does have incentives not to overpay.

Acting Chairman Downey. It does. It has incentives to not overpay. So that on the one hand you are saying that the moratorium decreases the incentive. On the other hand, the States have the incentive.

Ms. Bertini. They have some incentive, yes. But since at least 50 percent of the dollars they are receiving are Federal dollars, we believe that continued disallowances, and the end of the moratorium, would be helpful in terms of continuing the downward trend.

Acting Chairman Downey. Did you hear Senator Evans testify to the fact that he thought it was absurd or ridiculous—I forget the adjective he used—for the Federal Government to believe that a Governor of a State who is charged with the responsibility for not only State dollars but also for Federal dollars, would think that somehow this is free money, these hundreds of millions of dollars coming from the Federal Government, and I am going to be less concerned about how they are spent? Do you believe that?

How would you characterize what Senator Evans told us about the attitude that most Governors have with respect to the disbursement of Federal dollars for welfare? Are they not concerned that it be spent properly? Is not the principal incentive that the program operate effectively?

I am concerned by what I see as an adversarial system on the part of the administration vis-a-vis the States. I think that is counterproductive. And I would like you to address that. First, the Governor's statement that Governors are likely to be just as interested and responsible about the disbursement of Federal dollars. Do you believe that to be so?

Ms. Bertini. Yes, I think Governors are very committed to managing their States properly.

Acting Chairman Downey. Then who is not?

Ms. Bertini. We believe that the disallowances are important in terms of managing the systems properly.

We are not here to point the finger, sir, at any one particular person or group of people.

Acting Chairman Downey. Just 45 of 50 States.

What is the concrete evidence that you have to suggest that the moratorium has had some negative impact on the error rate?

Ms. Bertini. Since the moratorium is one of the few variable factors that has occurred in the last 2 years, we are viewing that as one of the potential reasons.

Acting Chairman Downey. Mr. Matsui.

Mr. Matsui. Thanks very much, Mr. Chairman. We had some testimony, a lot of testimony on this issue over the last 3 years. And the fact that the error rate in 1973 was 16.5 percent, in 1985 it was 6.05 percent is relevant to this discussion. But bear in mind that we did not start really collecting data until the early 1970's—1973 to be exact. And second, many of these programs that we are talking about here, food stamp programs and AFDC, expanded significantly after 1973.

It was natural that States had a very difficult time, frankly, adapting to additional Federal regulations, implementing larger programs that the Federal Government imposed on them, and going into an area that was virtually unknown to them. I frankly think that the States have improved in complying over the last 15 years or so, because they have become better adjusted to the system. They now understand it a lot better.

So perhaps the legislation or the law as it currently reads and the sanctions may have a slight effect. But the real improvement has little to do with sanctions. It is really a function of understanding what the programs are and administering them properly with more experience.

Ms. BERTINI. Yes, sir. We agree. And I do not want to suggest that disallowances are the only tools available because there are many other tools used as well. As I mentioned in my testimony, the States are very creative in some of the ways that they are using other tools to improve their programs.

Mr. MATSUI. I do appreciate the fact that you are going to take a look at the National Academy of Sciences' report and try to bring into your recommendations what they are suggesting, at least to the extent that you agree with some of their suggestions. I think that approach indicates a willingness to work with them, and of course, to working with us, which is vitally important on this particular issue.

Can you tell me a little bit about your study? Who was conducting your study? Who was in charge of it in the Department? Do you have any outside consultants that are working on it? How are they paid?

Ms. BERTINI. Yes, sir. In fact, I think I would like to defer to Mr. Storrs since he was the director of the study.

Mr. STORRS. At the outset, the Secretary established a steering committee chaired by the Assistant Secretary for Management and Budget. It consisted of the administrator of the Family Support Administration, the Administrator of the Health Care Financing Administration, and the Assistant Secretary for Planning and Evaluation in the Department. Also serving was the Assistant Secretary for Food and Nutrition Programs for the Department of Agriculture. Because they administer the food stamp program, we wanted to closely coordinate the two studies to try to achieve more consistency in the quality control programs.

They directed an interagency study group which I headed up as the study director. Staff from all of those components I just mentioned within the Department were involved.

We did let four separate consultant services contracts. One with Westat, Inc. for statistical services; Macro, Inc., a consulting firm that analyzed the management information; Kendrick & Company looked at the analysis of the socioeconomic variables and what effect they may have on the error rates; and Harold Russell Associates, a firm in Massachusetts which looked at the two-tier system and organizational alternatives to the two-tier system.

Mr. MATSUI. Now are these groups and your interagency group going to be looking at the National Academy report as well and analyzing it, giving us some recommendations with respect to it?

Mr. STORRS. That is our understanding of what the legislation mandated, the Secretary is to evaluate both reports, to make what changes he can, to apply those changes retroactively back to the past disallowances, and then to make any legislative suggestions to the committee.

Mr. MATSUI. Has your group or any of the statisticians analyzed any of the data from the National Academy?

Mr. STORRS. We have not done a complete analysis of the data. We just had a presentation by the National Academy of Sciences last Friday, as a matter of fact. We have certainly read their report and begun to analyze the information. But I would say it is in a preliminary stage.

Mr. MATSUI. From a statistical point of view, have any of your statisticians found fault with the National Academy's recommendations in terms of statistical information?

Mr. STORRS. I am going to have to apologize on this one because I have been out with surgery for the past 2 weeks—but I am not aware that we have got a final report from our statisticians, or even an informal report. I think there is some concern about their report. We believe there is some misunderstanding about the nature of measurement error that exists in the current system. We think there may have been some miscommunication between us and the National Academy to lead to the belief there is as much measurement error as they think.

We certainly recognize that there may be measurement error in the system. We have generally attributed that as being unidirectional; that is in the direction of understating the error rate because it is impossible for QC reviewers, either at the State level or the Federal level, to identify all errors. So certainly there is some. We think the controls that have been established generally reduce the amount of measurement error in it.

I think the National Academy of Sciences supported the use of the regression estimator, if you assume as we always have, that the true error rate is better established after the State review, followed by a Federal review with more information available. We clearly do think, after a second person looks at the information, the result is closer to the true error rate because any individual can make mistakes.

Mr. MATSUI. But I think the problem that the National Academy has with that, of course, is the fact that States really do not know what the standards are until after the second review. Then you do not really know how you can adjust to those errors until after it is all over.

Mr. STORRS. From my perception—and I am probably one of the few people here that has ever been a QC reviewer, I guess—most errors can be clearly established by objective fact. Either there is an error or there is not an error. There are some errors where there is a debate between the States and the Federal agencies that are a matter of policy interpretation. These are a very small portion of errors that are found.

Generally, 90–95 percent of the States' findings we agree with. We disagree with the findings in about 5 percent of the cases. The States agree with our decision in 60 percent of the differences.

Mr. MATSUI. That is the problem, 5 percent could mean the difference between a few hundred thousand or a few million dollars in terms of some of these States. And that is just the problem that we are facing right now. So 5 percent is a very critical factor.

As I have said, we have had a lot of testimony in this area, and I think that to know what an error is is a very iffy situation. We even asked HHS a few years ago what is an error and how they defined it, and their answer showed that those are subjects that really have to be discussed before you start the ballgame. You cannot do it in the ninth inning. And I am afraid that this is what happened in many of these cases.

Let me just go on to one other area. One item of major importance is the variations in socioeconomic conditions that you refer to. You do acknowledge that these will have an effect upon error rates; is that correct? I mean, in your testimony you indicate that.

Ms. BERTINI. Yes.

Mr. MATSUI. Again, I raise the case of Michigan during the recession when all of the sudden there was the surge of AFDC and food stamp requests, and as the Governor said, we just had a hard time dealing with that. And I guess Senator Evans mentioned that in the 1970's he had the same problem, and many States currently have that problem. Additionally, in California and New York there are many Hispanic and Puerto Rican recent arrivals, and they may have a hard time understanding some of the forms.

You do acknowledge that it is a problem. But at the same time you say that it is a problem, you say we really cannot deal with it. Why is that? I mean, why can you not deal with it? We spend $1 trillion a year. We have a very competent government. We want to build an SDI. I mean, can we not figure out how we are going to deal with these socioeconomic variations? It just seems to me, if we have the competence in those other areas, we should have it in this area.

Ms. BERTINI. Our consultants reviewed this in terms of dealing with different States and different factors, and trying to combine different factors into an adjustment model. The result was that you could not predict, ultimately, what would happen. In other words, one factor against another may skew the other factor to the point where it was not necessarily a fair model from one State to the other.

I will ask Mr. Storrs to amplify that.

Mr. STORRS. This is one of the most complicated subjects. I am going to try to be brief because it is a very technical subject.

Basically, we set out to try to identify a modeling approach for adjustment of the error rates. The first approach was to develop a comprehensive model by identifying all of the variables we knew that affected the error rates. The contractor identified 34 variables that correlated with error rates and developed a mathematical model.

On looking at the model results, some of the adjustments by State did not look reasonable. Because of sign reversals, they did not make logical sense. They employed a "diagnostic" technique and found that there was—and this is very technical—multi-colinearity, or excessive information overlap as a result of including all of those variables.

The solution to that problem is to reduce those statistical variables, by eliminating those that do not add to the explanatory power of the model. And they went through this process, eliminated 24 of the variables, and came up with a model which they felt was going to be an excellent model. It explained almost as much, 16 percent of the variation in the error rates with 10 variables, as had the more comprehensive model.

To test and make sure that this model was the model that ought to be used, they then said, we are going to set these 10 variables aside and go back to the 24 remaining variables and create another model and see how it compares with the model we have just developed. They came up with a third model that I think had seven variables—I may be wrong on the number. That third model explains—just as model two did—about 16 percent of the variation in error rates, but it has different variables. This would be fine if the adjustments that resulted from the separate models were comparable.

As it happens, the confidence intervals around those two models, for over 50 percent of the States, do not even overlap. The confidence interval, you would assume, contains the "true" adjustment that should be made for socioeconomic variables with 95 percent confidence. When you have over 50 percent of the States with two separate 95 percent confidence intervals that do not overlap, there has to be something wrong with the models.

What is wrong with the models, from our consultant's point of view is that too much of the reason behind the cause of error is unknown—85 percent or 84 percent unknown. We can only explain with the best model 16 percent of error variation. This allows so much bias to be introduced by the arbitrary selection of variables that you can pick and choose any model you want consisting of one variable, two variables, three variables, five and so forth. Each is going to have a different adjustment effect on every State.

As long as you recognize your choice is an arbitrary selection of variables, you can make an adjustment. But you cannot establish empirically which variables should be in or which variables should not be in the model. All you can tell is that they have different adjustment effects for different States.

And the negative consequence, if you adjust around the mean or the average State, is that some States are benefited and some States are disadvantaged. The variables you choose affect States differently. One model may affect California very beneficially and another model would be detrimental, and the threshold would be adjusted negatively. For example, one model year the one would say, the threshold for California should be 4 percent. Another model would say the threshold should be 2 percent.

Mr. Matsui. It would just seem to me that we should try to get a system that is as close to reality as possible, and it is obvious that this current system is not necessarily close to reality. Just comparing errors, technical and otherwise, does not necessarily mean one State has better management than another State. I think we ought to try to achieve that overall goal.

And frankly, it is obvious that variables have to be taken into consideration. We do that with the Joint Tax Committee every day. They give us recommendations involving hundreds of billions of dollars based upon human behavior. And I cannot see why in a situation like this we cannot do the same thing unless your real purpose is to obtain funds for deficit reduction.

I do want to thank you, and I look forward to working with all of you. I am just hopeful that we are going to be able to solve this problem satisfactorily because it is a large one and it has to be dealt with.

Mr. Pease?

Mr. **Pease**. Thank you very much, Mr. Chairman. I also appreciate your testimony. I would like to ask a couple of questions.

Ms. Bertini, you said in your testimony that the error rate had been reduced from 16.5 down to 7.2. The first time we embarked on any kind of penalties was 1981 or 1982, was it not?

Ms. **Bertini**. In 1975, there began a system to review these cases, and there were disallowances built in through regulations. They never were administered.

Mr. **Pease**. Those regulations were struck down; is that right, as not being constitutional?

Ms. **Bertini**. I am afraid I do not know.

Mr. **Pease**. I think that is——

Ms. **Bertini**. Yes, they were.

Mr. **Pease**. So we did not have a statutory system in place—sanctions—until after this administration came into office. Is that correct?

Ms. **Bertini**. That is correct.

Mr. **Pease**. I am looking at the historical trends in AFDC error rates. In April to September 1981, which would have been before any action by this administration could have been felt, the error rate was 7 percent. It then went up to 7.2 percent in 1982, October to March. And went down slightly, and is now back up to 7.2 percent. It looks to me as if we are exactly where we were 6 years ago.

Ms. **Bertini**. Sir, first if I could just correct one statement you made at the beginning of your question. My testimony was that we decreased from 16.5 to 6 in 1984. Basically, I was making the point that after 1984 that we had an increase and the 7.2 figure—7.1 actually—that you refer to is the 1986 figure.

Mr. **Pease**. I was afraid that you were trying to indicate when you mentioned 16.5, that this program had been successful in bringing down error rates.

Ms. **Bertini**. We think all of the various components of the quality control program have been successful in bringing down error rates, with the disallowance portion being only one of those.

Mr. **Pease**. In relation to sanctions though, they have not been brought down at all. Is that right? Sanctions started being applied in 1982. The rate was then 7.2 percent. And in September 1986, the error rate was 7.2 percent.

Ms. **Bertini**. If I might suggest that there is another error rate chart that refers to annual error rates, that you are looking at, as opposed to 6-month error rates, and there are two different ways of compiling those.

Mr. **Pease**. We will look at those also. Anyhow, the point that I want to make is that looking at this chart which shows the latest period, October 1985 to September 1986, it shows 7.2 percent for that period. The lowest rate it shows during any time in the 1980's was 5.7 percent. Does that comport with what you have?

Ms. **Bertini**. 5.99 percent actually in 1984, which we are calling 6 percent, is the lowest in the 1980's.

Mr. **Pease**. Based on that performance, is there any hope whatsoever of getting it down to 3 percent which is the statutory point right now?

Ms. **Bertini**. We believe so. We believe it is still a good target to use. And since five States have recently reached that level, and other States have in the past, we think that it is a good target to work toward that States can ultimately reach.

If I might, Congressman, suggest that the 3 percent tolerance was basically a decision the Congress made to say we know there will be some errors in the way the system works. So we will tolerate a 3 percent error rate without asking for States to be specifically accountable in terms of returning those dollars.

We are still talking about basically $4.5 billion in those years you are referring to, that were misspent dollars. If we then talk about the Federal share, we are talking about $2.4 billion. And after you subtract the 3 percent from that, we are talking about the $800 million in misspent dollars.

I think the bottom line is, what level does Congress want to establish for allowing State errors. We believe that 3 percent is an adequate level.

Mr. **Pease**. You heard from earlier testimony that there has been considerable question about whether the errors which constitute this error rate are really misspent Federal dollars or other errors. Could you comment on that?

Ms. **Bertini**. Certainly. There are other errors or other considerations that go into this compilation. Again, that is why we think that 3 percent is a tolerable rate to include some of the other errors that are discussed. But, with respect to actually misspent dollars, the Federal Government has responsibility to either see that that does not happen or to have those dollars returned to the Federal Treasury.

Mr. **Pease**. Thank you.

Thank you, Mr. Chairman.

Mr. **Matsui** [presiding]. Thank you, Mr. Pease.

Mr. Frenzel.

Mr. **Frenzel**. Thank you very much, Director Bertini. What, in your opinion, would happen to State performance if Congress does not establish new criteria or standards but merely extends the moratorium another year?

Ms. **Bertini**. We believe, Mr. Frenzel, that if the moratorium is extended that it will be one less reason for the States to be as diligent as possible in terms of being careful about their error rates.

Mr. **Frenzel**. Do the States, in your opinion, believe that we are not going to demand that they perform according to the law because of the moratorium?

Ms. **Bertini**. We think that the States do in the vast majority of the cases, perform according to the law. However, since we have yet to collect any disallowances from any State, as an effort to decrease the errors and to return dollars to the Federal Treasury—we have not seen the full potential of this process to get States to reduce error rates below 3 percent.

Mr. **Frenzel**. Have any States begun a legal contest of the standards?

Ms. **Bertini**. I understand that initially in 1981, when the 1981 disallowances occurred that, some States did challenge those standards.

Mr. **Frenzel**. Have any of those challenges been completed?

Ms. **Bertini**. No, sir; the Grant Appeals Board put aside those issues when the moratorium was put into effect until there is some policy resolution, and then they would look to resolve the cases.

Mr. **Frenzel**. Are none of those cases moving forward in any courts now?

Ms. **Bertini**. It is my understanding that those 1981 cases are static at this point.

Mr. **Frenzel**. Did they originate within your department?

Ms. **Bertini**. Yes, sir.

Mr. **Frenzel**. If appeals at HHS are exhausted, can the States then appeal to the court system?

Ms. **Bertini**. Yes.

Mr. **Frenzel**. So they have never gotten anywhere because of the moratorium?

Ms. **Bertini**. That is correct.

Mr. **Storrs**. If I might just clarify one thing. The reason the Grant Appeals Board decided to stay the 1981 appeals without prejudice is because of the interpretation of the statutory language. After the two studies the Secretary is required to reevaluate the system, make any changes he would feel necessary based on the two studies, and apply those adjustments to past disallowances. The Grant Appeals Board decision assumed some changes may occur that would affect those past disallowances. Since that is the case, the Board did not issue a decision on those appeals.

Mr. **Frenzel**. It is not good policy to let those penalties hang. I recall that at one time we had no penalties for States that did not pay back their borrowings from unemployment compensation. So States who were having not to make payments enjoyed their debtorhood. Then when we insisted that they pay, they began grudgingly to make payments.

I wonder if we have a similar situation with the penalties here. States are never going to pay them, or undergo what may be an expensive process necessary to improve the quality of their AFDC administration, until we insist that they do so. Is that the possibility here?

Ms. **Bertini**. Yes, I think so.

Mr. **Frenzel**. I share some of my colleagues' complaints about the system. On the other hand, I sure do not want to condone bad performance—even if it is by all 50 of the States. I do not believe that shabby performance, simply because it is indulged in by the entire universe, ought to be something we encourage.

Can you tell me when we might expect to have a statement from the Secretary about the Academy's study? You indicated that you had received your first briefing and were studying the report, and that at some point the Department would render its cosmic judgment on whether there was some merit in the Academy's study. Can you tell us when we might expect to see that?

Ms. BERTINI. We are working on it diligently now. We do not have a specific due date to report back to you. But knowing about the timeliness of other concerns, for instance, the end of the moratorium, we are trying to review this within that time period.

Mr. FRENZEL. I do not want to second-guess either the chairman, the acting chairman, or the acting, acting chairman, but I think this subcommittee intends to do something before the moratorium expires. We will do it a lot better if we have the benefit of your judgment on their report. Without your help, we will probably do something that is not so good.

Ms. BERTINI. We will work with dispatch, sir, to get you our comments on the Academy's report.

Mr. FRENZEL. Thank you for your testimony. Yield back my time.

Mr. MATSUI. Thank you, Mr. Frenzel.

I would like to thank both of you, and particularly you, Ms. Bertini, for being here and for testifying today. Thank you.

Ms. BERTINI. Thank you.

Mr. MATSUI. I would like to now call to the witness table, from the American Public Welfare Association, Patricia Barry and Leslie Frye.

I would like to thank you both very much for attending today. And of course, as Chairman Downey had said earlier in the hearing, your written testimony will be entered into the record.

Ms. Barry.

STATEMENT OF PATRICIA BARRY, DIRECTOR, OHIO DEPARTMENT OF HUMAN SERVICES, ON BEHALF OF THE NATIONAL COUNCIL OF STATE HUMAN SERVICE ADMINISTRATORS, AMERICAN PUBLIC WELFARE ASSOCIATION

Ms. BARRY. Mr. Chairman and members of the subcommittee, thank you for this opportunity to appear before you to discuss the pressing need for reform of the AFDC quality control system. I am Patricia Barry, director of the Ohio Department of Human Services. I am pleased to be here to testify on behalf of the American Public Welfare Association and its National Council of State Human Service Administrators.

This committee has a long and laudable record on the issue of quality control reform. The committee's leadership, and particularly your contributions, Mr. Matsui, have been wholeheartedly supported by State human service administrators. The National Academy of Sciences' and HHS' quality control studies discussed this morning are the result of efforts by this committee to have Congress address the need for reform.

The National Academy of Sciences confirmed what States have known and contended for a long time: the present AFDC quality control system produces a measure of States performance that is neither accurate or equitable. Nonetheless, the system is used to assess millions of dollars of fiscal penalties against the States. Forty-nine States face quality control sanctions of close to $600 million in the AFDC program alone for the years 1981 to 1984. Ohio alone is considered liable for over $29 million for these years. Until it is reformed, the quality control system will undermine States efforts to make the AFDC program work the way the public wants it to, and to work fairly and equitably. Instead of strengthening the AFDC program, punitive fiscal sanctions may well force States to curtail benefits to their clients or services as well as the very administrative improvements needed to maintain and reduce errors. These results, of course, are the opposite of what the quality control program is supposed to accomplish. And they are exacerbated when you consider that the same quality problems exist in the Medicaid and food stamp programs.

Ohio's total across all those three programs is over $111 million in sanctions. That $111 million is more than we have to support child support enforcement in our State and the WIN program combined. As a matter of both social and fiscal policy, the system as they now exist must be changed.

With over $111 million, Ohio could provide 51 days worth of cash assistance to all of the 641,000 clients on AFDC, or 56 days worth of food stamps to all 1 million recipients of food stamps in the State, or 19 days worth of medical care to over 500,000 Medicaid recipients.

With $111 million, Ohio could provide 1 year's worth of day care to over 25,000 children, and provide 12 months of extended Medicaid to over 21,000 single parent families.

With $111 million, Ohio could fund all the costs of the development of a massive automated system like CRIS-E, with still enough money left over to operate that system for nearly 3 years.

Approximately $40 to $60 million of accumulated sanctions is caused by client error in Ohio, not worker error.

With $111 million, Ohio could fund all county income maintenance operations for over 6 months. The $111 million represents over 2 years worth of salaries and fringe benefits to all of our caseworkers in Ohio's 88 county departments; $111 million of sanctions could fund Ohio's current work and training program for the next 6 years.

My testimony today will focus on change and reform of the current system. We have worked closely with your staff, Mr. Matsui, and feel confident that the legislation you intend to introduce will correct the most egregious flaws of the current system and put in place a quality control system that is accurate and fair.

The delayed release of HHS' study prohibits me from being able to comment extensively on the Department's findings. It is not surprising, considering the current administration's position on fiscal sanctions, that the study supports the current system and sees little need for change.

Rather than taking a great deal of time responding to each one of the National Academy of Science's recommendations, I will focus on the most significant findings, then discuss what goals for reform should be.

The Academy's report lends additional credibility to the work of this committee, to the views of the States, and the urgent need for reform. The Academy finds the current quality control system in the AFDC program to be significantly flawed. The Academy proposes comprehensive reform and movement towards a quality improvement system.

The key elements of the reform proposed by the Academy, in general, are supported by the American Public Welfare Association and state directors. These key elements recommended by the Academy are consistent with the goals for reform that States have identified. We need quality control legislation that will reverse the current inequities in the quality control system and provide a suitable basis for assessment and sanction.

Quality control reform legislation must do the following: establish accurate and efficient procedures to measure error; eliminate the risk of overpenalizing States; expand the focus of the quality control system; establish reasonable standards of performance; minimize the arbitrariness of the fiscal sanctions; address the effect of uncontrollable factors on the error rate; and offer a fair resolution of pending disallowances.

Standard quality control procedures must be established so that State and Federal quality control reviews are conducted within similar timeframes and following the same standards. States would be responsible for submitting quality improvement plans to HHS for review and approval. This would not necessitate the federal prescription of specific corrective action measures. It would simply require HHS to develop reasonable, objective criteria for quality improvement plan approval.

As long as the Department is going to set standards for the States and make determinations regarding what are appropriate state corrective action strategies during the waiver process, we believe HHS should be similarly involved at the initiation of the corrective action process and held accountable for its decisions. This is consistent with the National Academy's recommendations and reflective of the need for stronger Federal commitment.

Procedures for granting States good faith waivers are included in the bill. Given HHS' past performance with regard to reviewing these requests and the delay in the long-promised revisions of that process, waive procedures should be codified to ensure federal decisions are made fairly and soundly.

Expanding the focus of the quality control system is important. The current system measures only one aspect of program performance, payment accuracy. The Academy's study, as well as the HHS study, recommends a system that focuses on underpayments and improper denials as well as overpayments and payments to ineligibles. As administrators we are, and must continue to be, as equally concerned about underpayments and improper denials. The exclusive emphasis on payment accuracy under the current QC system has distorted the aim of the AFDC program.

The National Academy of Science study states, "current thresholds are not now scientifically grounded and do not relate to the actual or potential capability of individual states." The Academy then goes on to point out, "there is something wrong with a system that still finds nearly all of the operational units doing poorly in the face of this record of improved national performance."

As Chairman Downey said this morning, when the majority of a class fails, it is time to begin to look at the teacher and not at the students.

Despite the considerable investment made by the States to reduce errors, only one State has been able to achieve a 3-percent standard for more than a year and-a-half. Clearly, 3 percent is an unrealistic standard given the complexity of the AFDC program. As one of the most complex endeavors of the public sector, AFDC is inherently prone to some level of error.

Eligibility workers must examine a myriad of factors to determine eligibility and benefits under severe time constraints. Federal quality control reviewers, on the other hand, review only a small percent of AFDC cases over a much more extended period of time and with the benefits of the results of the State's own quality control review. In effect, States are penalized for failing in their regular determinations to perform at a level achieved by Federal reviewers.

The reasonableness of the current 3 percent tolerance, given States experience, the effort that has already been made in corrective action, and the Academy's findings, merits revision. States will continue to strive for lower errors regardless of the national tolerance level. Our large financial stake in these programs requires us to. For example, in Ohio every half of a percent in error costs the State $1.6 million.

As long as the Federal Government chooses to impose fiscal sanctions based on quality control performance, however, it is critical that reasonable and accurate standards are set. We are not advocating that the tolerance be eliminated. We ask that it be realistic. Given the findings of the Academy, States feel that the target should be related to the national average. This is a fairer and more representative tolerance based on current potential.

We also recommend that the tolerance be reviewed periodically. This is consistent with the Academy's recommendations that the tolerance level should be modified to address changing circumstances.

Minimizing the arbitrariness of fiscal sanctions is important. To minimize the arbitrariness of the current system, technical errors must be excluded when computing the sanction. Under the current AFDC system, technical or procedural errors—errors unrelated to recipients need or eligibility for assistance—count the same as actual eligibility and payment errors when calculating the error rate on which penalties are ultimately based.

The National Academy recommends that technical errors continue to be identified as part of the quality control system, but sanction determinations should not include these paperwork omissions. States could continue to seek improved methods of controlling them as warranted to assure the fulfillment of eligibility requirements.

Addressing the effect of external and uncontrollable factors on the error rate is extremely important to States. The Academy recommends that State tolerance levels be adjusted to reflect sociodemographic differences. According to the National Academy's findings, "the performance threshold should be adjusted to accommodate State-to-State differences in error-proneness over which States have no control."

It is not only unfair but illogical to hold 50 States responsible for the same level of accuracy when program characteristics are so different in each State.

It is important that the legislation to reform the current system recognize the need for sufficient time to implement new policy changes without the threat of sanctions. HHS currently has the authority to provide grace periods when implementation of new policy takes place. Grace periods should be mandatory when significant policy changes are required.

To implement a new policy takes time and careful planning. Writing policy and administrative rules, plus computer programming changes require 3 to 4 months at a minimum in a State as large as Ohio. Training for county workers takes another 2 to 4 months in a State that has over 4,000 caseworkers. It is all too frequently the case that the State receives the Federal regulations just before they become effective and little if any time is available for State and county planning of implementation. Is it any wonder that States cannot reach the 3-percent tolerance level?

The National Academy recommendations have to offer a fair solution to the resolution of the pending sanctions. As I stated earlier, how to fairly deal with the backlog of sanctions. There are millions of dollars in sanctions pending against the States and their human services budgets—sanctions that are based on an indisputably flawed system.

The National Academy acknowledged the difficulty of providing an ideal solution. They did, however, propose a couple of different options for treatment of past sanctions. Mr. Matsui, you are considering a combination of these recommendations for past sanctions. This approach would determine the extremes of performance by comparing State performance.

The States determined to be extremely poor performers would be liable for sanctions. Sanctions would be determined based on the lower bound of the error rate range and minus the technical errors. By applying the lower bound and adjusting for technical errors, those States determined to be at the extremes would not carry the full burden of an unfair process.

Let me conclude by pointing out that the States, no less than the Federal Government, are committed to the concept and practice of quality control. They want to ensure that limited public assistance funds go only to recipients who meet the requirements. We believe our performance, as well as the substantial investments we have made and continue to make in error reduction reflect this commitment.

States have made tremendous strides in reducing error rates. The national AFDC error rate dropped more than 50 from 16.5 percent in 1975 to 6 percent in 1985. The National Academy study recognizes State commitment and progress. It is the States' investment in efforts to improve program management and reduce errors that has resulted in the decline of error rates.

As performance has improved, however, the sanctions have continued to increase. Under current sanction policies in AFDC, States face the loss of millions of dollars over the next few fiscal years. States face comparable sanctions in Medicaid and food stamp programs. The vast majority of States will not be able to absorb this loss at this magnitude without major impact on our programs. Severe fiscal sanctions pose a serious threat to the integrity of our programs. They give the appearance of being little more than a backdoor approach to reversing the longstanding Federal financial commitment to the AFDC program.

As a result, States may well be forced to eventually cut back the services and benefits they provide to needy families. Given the fact that the purchasing power of AFDC benefits has already fallen 35 percent when adjusted for inflation since 1970, we think every effort should be made to avoid such a consequence.

I want to assure you that the States and State directors are committed to working with this committee and other members of Congress to successfully reform the current quality control system. The cost of not acting now may be great.

Thank you very much for this opportunity to testify. I would be glad to answer any of your questions.

[The statement of Patricia Barry follows:]

TESTIMONY OF

Patricia Barry

DIRECTOR, OHIO DEPARTMENT OF HUMAN SERVICES

Representing

NATIONAL COUNCIL OF STATE HUMAN SERVICE ADMINISTRATORS

of the

AMERICAN PUBLIC WELFARE ASSOCIATION

For The

COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON PUBLIC ASSISTANCE AND UNEMPLOYMENT COMPENSATION

Hearing on the Quality Control System
in the Aid to Families with Dependent Children Program

April 12, 1988

Mr. Chairman, and members of the Subcommittee, thank you for this opportunity to appear before you to discuss the pressing need for reform of the AFDC quality control system. I am Patricia Barry, Director of the Ohio Department of Human Services. I am pleased to be here to testify on behalf of the American Public Welfare Association and its National Council of State Human Service Administrators.

This committee has a long and laudable record on the issue of quality control reform. The committee's leadership, and particularly the contributions of Mr. Matsui, have been wholeheartedly supported by state human service administrators. The National Academy of Sciences' and HHS' quality control studies discussed this morning are the result of efforts by this committee to have Congress address the need for reform.

The National Academy of Sciences confirmed what states have contended and this committee has long understood: the present AFDC quality control system produces state performance measures that are neither accurate nor equitable. Nonetheless, the system is used to assess millions of dollars in fiscal penalties against the states. Forty nine states face quality control sanctions totaling nearly $600 million in the AFDC program for fiscal years 81-84. Ohio alone is considered liable for over $29 million for these years. Until reformed, the quality control system will undermine state efforts to make the AFDC program work the way the public wants it to work--fairly and efficiently.

Instead of strengthening the AFDC program, punitive fiscal sanctions may well force states to curtail benefits or client services, as well as the very administrative improvements needed to reduce errors. These results, of course, are the opposite of what the quality control program is supposed to accomplish. And they are exacerbated when you consider that the same quality control problems exist in the Medicaid and Food Stamp programs. In Ohio, for example, we project our accumulated sanctions for AFDC, Medicaid and food stamps for FY 81-FY 87 will exceed $110 million. Let me translate this money into services for you:

- With $111,869,005, Ohio could provide 51 days worth of cash assistance to all of its 641,466 recipients of AFDC, or 56 days worth of Food Stamps to all 1,062,404 recipients, or 19 days worth of medical coverage to all 505,386 recipients of Medicaid.

- With $111,869,005, Ohio could provide 1 year's worth of day care to over 25,000 children, AND provide 12 months of extended Medicaid to over 21,000 single parent families.

- With $111,869,005, Ohio could fund all costs of the development of a massive automated system like CRIS-E, and still have enough money left over to operate the system for nearly 3 years.

- With $111,869,005, Ohio could fund all county income maintenance operations for over 6 months.

- $111,869,005 represents over 2 years worth of salaries and fringes to all of the caseworkers in Ohio's 88 county departments of human services.

- $111,869,005 could fund Ohio's current work and training programs for almost the next 6 years.

My testimony today will focus on needed reform to the current system. We have worked closely with Mr. Matsui's staff to assure that the legislation he intends to introduce will correct the most egregious flaws of the current system and put in place a quality control system that is accurate and fair.

HHS' Quality Control Study

The delayed release of the HHS study prohibits me from being able to comment extensively on the Department's findings. It is not surprising, considering the current administration's position on fiscal sanctions, that the study supports the current system and sees little need for change. What is significant is that the National Academy of Sciences, a respected and objective reviewer, when given an identical charge by Congress, did not agree with HHS findings.

The National Academy of Sciences' Quality Control Study

Rather than taking a great deal of time responding to each of the NAS recommendations, I will focus on the most significant findings then discuss what the goals for reform should be.

The NAS report lends additional credibility to the work of this committee, the views of the states, and the urgent need for reform. The NAS finds the current quality control system in the AFDC program to be significantly flawed. The Academy proposes comprehensive reform, and movement toward a "quality improvement" system.

The key elements for reform proposed by the Academy are:

- The system should include rewards for good performance as well as sanctions.
- Measures of performance to which financial consequences are attached should include criteria other than to overpayments.
- Performance standards should reflect state-to-state differences in caseload composition.

- When states are operating at realistic levels of performance, thresholds for sanctions and rewards should be set so that only states at the extreme of good or bad performance are subject to rewards or sanctions.

- Special technical assistance should be provided to the few states that remain poor performers.

- Federally approved state plans should provide the measurement standards against which performance is assessed.

- Performance standards should change over time to reflect changing performance capabilities.

Goals for Reform of the Quality Control System

The key elements recommended by the Academy are consistent with the goals for reform that states have identified. We need quality control legislation that will reverse the current inequities in the system and provide a suitable basis for assesssment and sanction. Quality Control reform legislation must do the following:

- establish accurate and efficient procedures to measure error,

- eliminate the risk of overpenalizing states,
- expand the focus of the quality control system to include underpayments and improper denial,
- establish reasonable standards of performance,
- minimize the arbitrainess of fiscal sanctions,
- address the effect of uncontrollable factors on the error rate, and
- offer a fair resolution for pending disallowances.

Establish Accurate and Efficient Procedures to Measure Error

Standard quality control procedures must be established so that state and federal quality control reviews are conducted within similar timeframes and following the same standards. States would be responsible for submitting quality improvement plans to HHS for review and approval. This would not necessitate the federal prescription of specific corrective action measures; it would simply require HHS to develop reasonable, objective criteria for quality improvement plan approval. As long as the department is going to set standards for the states and make determinations regarding what are appropriate state corrective action strategies during the waiver process, we believe HHS should be similarly involved at the initiation of the corrective action process and held accountable for its decisions. This is consistent with the National Academy's recommendations and reflective of the need for a stronger federal commitment.

Procedures for granting states good faith waivers are included in the bill. Given HHS' past performance with regard to reviewing these requests, and the delay in the long promised revisions to the process, the waiver procedures should be codified to ensure federal decisions are made fairly and soundly.

Eliminate the Risk of Overpenalizing the States.

The error rate computed for a state should be the lower boundary of the error rate range produced by sampling procedures. This would eliminate the risk of overstating a state's error rate thereby imposing higher-than-warranted sanctions.

Under current procedures a state may be subject to a penalty because its mid-point error rate exceeds the federal tolerance, even though the lower end of its error range falls below the tolerance. Therefore, there is a real potential that states will be subject to penalties for errors they did not commit. Use of the lower bound safeguards against overpenalizing states. The use of the lower bound for penalty assessment has been supported by other government agencies and by the General Accounting Office, as well as a 1982 study by the NAS. The NAS' recent study recommends that the midpoint be used only if the system is completely reworked to compensate for the current inadequacies.

Expand the Focus of the Quality Control System

The current system measures only one aspect of program performance, payment accuracy. The NAS study,as well as the HHS study, recommends a system that focuses on underpayments and improper denials, as well as overpayments and payments to ineligibles. As administrators we are, and must continue to be, equally as concerned with underpayments and improper denials as the exclusive emphasis on payment accuracy under the current QC system has distorted the aim of the AFDC program. The states and federal government do not currently have sufficient information on underpayments and improper denials to develop standards for performance in this area. We propose that equal focus be given to underpayments and improper denials and that methodologies be developed to measure and assess state performance in these areas. Under a quality control system that is not inordinately punitive states and HHS will be able to provide consistent attention to all mispayments.

Establish Reasonable Standards of Performance

The National Academy of Sciences study states, "current thresholds are not now scientifically grounded and do not relate to the actual or potential capability of individual states." The Academy then goes on to point out, "there is something wrong with a system that still finds nearly all of the operational units doing poorly in the face of this record of improved national performance." Only two states have consistently met the national target for the period of 1981-1984. Forty two states anticipate error rate notification for FY 85, and 49 states, including the territories and the District of Columbia, did not meet the national tolerance level for FY 84.

Despite the considerable investment made by the states to reduce errors, only one state has been able to achieve the 3% standard for more than a year and a half and less than 10% of the states have been able to maintain an error rate below 4% for the same length of time.

Clearly 3% is an unrealistic standard given the complexity of the AFDC program. As one of the most complex endeavors of the public sector, AFDC is inherently prone to some level of error. Eligibility workers must examine a myriad of factors to determine eligibility and benefits under severe time constraints. Federal quality control reviewers, on the other hand, review only a small percentage of AFDC cases over a much more extended period of time and with the benefit of the results of the state's own quality control review. In effect, states are penalized for failing in their regular determinations to perform at the level achieved by federal reviewers.

The reasonableness of the current 3% tolerance, given states' experience, the effort that has already been made in corrective action, and the NAS findings, merits revision.

States will continue to strive for lower errors regardless of the national tolerance level. Our large financial stake in the program requires us to. For example, in Ohio every half of a percent in error costs the state $1,689,067.00. As long as the federal government chooses to impose fiscal sanctions based on quality control performance, however, it is critical that reasonable and accurate standards are set. We are not advocating that the tolerance be eliminated. We ask that it be realistic.

Given the findings of the Academy, states feel that the target should be related to the national average. This is a fairer and more representative tolerance based on current potential. We also recommend that the tolerance be reviewed periodically. This is consistent with the NAS recommendation that the tolerance level should be modified to address changing circumstances.

Minimize the Arbitrariness of Fiscal Sanctions

To minimize the arbitrariness of the current system technical errors must be excluded when computing sanctions. Under the current AFDC system technical (or procedural) errors --errors unrelated to recipients need or eligibility for assistance -- count the same as actual eligibility and payment errors when calculating the error rate on which penalties are ultimately based.

In both the Food Stamp and Medicaid programs technical errors are not used to compute sanctions. Discrepancies that are technical, but that would not result in a change in benefit levels if they are corrected, are not counted as errors. Counting these technical discrepancies as payment errors, although dollar loss is not usually involved, can add up to one or two percentage points to the AFDC error rate.

The National Academy recommends that technical errors should continue to be identified as part of the quality control system, but sanction determinations should not include these paperwork omissions. States would still continue to seek improved methods of controlling them as warranted to assure the fulfillment of eligibility requirements.

Address the Effect of External, Uncontrollable Factors on the Error Rate

The NAS recommends that state tolerance levels be adjusted to reflect socio-demographic differences among states. According to NAS findings "the performance threshold should be adjusted to accommodate state-to-state differences in error-proneness over which states have no control."

It is not only unfair but illogical to hold 50 states responsible for the same level of accuracy when program characteristics are so different in each state. A state with more complex benefit programs and a large recipient population will face more difficult obstacles in reducing its error rates than will a state with simpler programs and fewer recipients. A reasonable tolerance level cannot ignore such factors. Adjustments for factors such as the number of households with earnings, population density and program complexity must be included in a reformed system.

It is also important that legislation to reform the current system recognize the need for sufficient time to implement new policy without the threat of sanction. HHS' currently has the authority to provide grace periods for the implementation of new policy. Grace periods should be mandatory when significant policy changes are required. To implement a new policy takes time and careful planning. Writing policy and administrative rules plus computer programming changes require 3 to 4 months at a minimum. Training for county workers takes another 2 - 4 months in a state that has over 4,000 caseworkers. It is all too frequently the case that the state receives the federal regulations just before they become effective and little if any time is available for state and county planning and implementation or training.

Offer A Fair Solution to the Resolution of Pending Sanction Liabilities

One of the most difficult decisions in looking toward reform is how to fairly deal with the backlog of sanctions. As I stated earlier, there are millions of dollars in sanctions pending against the states and their human service budgets -- sanctions that are based on an indisputably flawed system.

The National Academy acknowledged the difficulty of producing an ideal solution. They did, however, propose a couple of different options for treatment of past sanctions. A combination of the NAS recommendations for past sanctions may be a credible solution. Such an approach would determine the extremes of performance by comparing state performance, as recommended by NAS. The states determined to be extremely poor performers would be liable for sanctions. Sanctions would be determined based on the lower bound of the error rate range and minus technical errors. By applying the lower bound and adjusting for technical errors these states determined to be at the extremes would not carry the full burden of an unfair process.

* * *

Let me conclude my statement by pointing out that the states, no less than the federal government, are committed to the concept and the practice of quality control. They want to ensure that limited public assistance funds go only to recipients who meet the eligibility requirements. We believe our performance, as well as the substantial investments we have made and continue to make in error reduction reflect this commitment. States have made tremendous strides in reducing their error rates. The national AFDC error rate dropped more than 50% from 16.5% in 1975 to 6.5% in 1985. The NAS study recognizes state commitment and progress. It is the states' investment in efforts to improve program management and reduce errors that has resulted in the decline in the error rate.

As performance has improved, however, the sanctions have continued to increase. Under current sanction policies in AFDC, states face the loss of millions of dollars over the next few fiscal years. States face comparable sanctions in the Medicaid and Food Stamp programs. The vast majority of states will not be able to absorb a loss of this magnitude without major impact on programs. Severe fiscal sanctions pose a serious threat to the integrity of state programs. They give the appearance of being little more than a backdoor approach to reversing the long-standing federal financial commitment to the AFDC program. As a result, states may well be forced to eventually cut back the services and benefits they provide to needy families. Given the fact that the purchasing power of AFDC benefits has already fallen 35% when adjusted for inflation since 1970, we think every effort should be made to avoid such a consequence.

I want to assure that states are committed to working with this committee and other Members of Congress to successfully reform the current quality control system. The cost of not acting now may be great.

Thank you for the opportunity to testify.

Acting Chairman DOWNEY. Ms. Frye.

STATEMENT OF LESLIE FRYE, CHIEF, CORRECTIVE ACTION BUREAU, CALIFORNIA STATE DEPARTMENT OF SOCIAL SERVICES, ON BEHALF OF THE AMERICAN PUBLIC WELFARE ASSOCIATION

Ms. FRYE. My name is Leslie Frye. I am the chief of the Corrective Action Bureau in the State of California Department of Social Services. My responsibility is to assist California's 58 counties to reduce their payment error rates in the AFDC and food stamp programs. I thank the subcommittee for the opportunity to share our point of view.

I have a prepared statement which I would like to submit for the record which echoes much of what Ms. Barry has said with regard to the flaws of the current quality control system and the fiscal sanctions it imposes.

Rather than reiterating California's points of agreement with the National Academy of Sciences' study and Ms. Barry's testimony and our concerns with the current system—which has resulted, by the way, in a sanction liability for the AFDC program alone in California through 1985 of about $160 million—I want to focus on the tolerance level of performance level of 3 percent, particularly as a motivator of improved performance. We believe that this feature is one of the most problematic elements of the current system.

We are not opposed to sanctions in the cases of extreme chronic poor performance coupled with demonstrated unwillingness to work toward improvement. However, the current Federal system does not operate under these constraints. The result, as we have known and discussed this morning, is sanction liability for most States which forces massive expenditures and direction of resources towards justifying past performance rather than correcting ongoing problems.

I thought it was interesting this morning in the discussion about the period of time at which the error rate fell and when it began to increase again. And I want to point out that the current system provides error rate data and notification of sanctions some 2 to 3 or 4 years after that occurs, after the reviews are conducted, or at least the period for which the reviews are conducted. I would suggest that during those periods of error rate creeping up again, those are the periods of time during which we are preparing our defense against the imposition of the sanction, something which we are regulatorily limited to certain time periods to do.

I know that in my office we spend a great deal of time, as do our 58 county welfare departments, when a notification of sanction arrives, gathering evidence to demonstrate our good faith efforts toward error reduction. And of course, this only detracts from our ability to prospectively improve programs.

These defensive exercises, of course, have detracted from a good Federal-State relationship, and in our State where we are locally administered programs, it detracts from a good State-local relationship.

The study of the quality control system released by the Department of Health and Human Services just recently, and which I also have not had an opportunity to review thoroughly, does imply that the stringent performance level and the threat of disallowance are responsible largely for the great improvement in State performance since 1973. And I would again emphasize that I do not think this is the case.

During the 1970's we saw the greatest improvement in program performance, and I suggest that this is due to factors such as income reporting, which was universal in California long before it became a federal requirement, and the improvements in technology, such as automated case processing and computer match systems.

A June 1987 report released by the Department of Health and Human Services' Office of Inspector General found universal, near universal agreement that a 3-percent tolerance level is impossible to reach. However, despite this consensus in this most recent study, the Department found in favor of retaining the 3 percent even though it acknowledges that failure to reach and maintain that level will result in fiscal sanctions for States.

We believe that the tolerance is unrealistic and does not reflect those complexities which Congress has built into the program in order to target benefits toward particular segments of the population. And that is a policy choice, but I think the 3 percent is inconsistent with that.

I began my public service career as an eligibility worker in Contra Costa County, Calif., and those years as an eligibility worker left me with a deep appreciation of the difficulties that caseworkers face daily dealing with families in need of food, clothing, shelter and a whole lot of support. An eligibility worker must apply hundreds of complex regulations to these real world situations, and do so quickly, fairly, and compassionately.

Despite these pressures, improving their accuracy rate, as we prefer to call it in California, is also an important responsibility of an eligibility worker. There is not an EW in the State of California who is unaware of the importance of providing the right amount of benefits to eligible persons, and who is unaware of how his or her county and the State as a whole are performing.

In fact, in California we rely on the front line eligibility worker for creative yet practical and effective solutions to error problems. They know the programs best and are in the best position to improve program operation at the point where errors occur.

It concerns me greatly that the message we give EW's, despite the significant improvements that we and other States have made in the last several years, is that they have failed. They and all of us involved in administering welfare programs have failed because we have not met the arbitrary performance standard of 3 percent.

A basic tenet of human behavior is that achievable goals challenge people while unrealistic goals only frustrate and discourage them. We strongly urge that the performance standard for AFDC be established at a level which many States have achieved. A performance standard within our reach can help us improve our accuracy rate. One that has been shown year after year to be impossible for most States to achieve or maintain serves no positive purpose.

The current AFDC quality control and sanction system is damaging to the program it purports to improve. There is very likely a public perception that our welfare programs are largely mismanaged when four-fifths to 90 percent of States cannot achieve the performance standards established in law. And also there is very likely an erosion of public confidence and support in these greatly needed programs.

So California joins other States in urging Congress to follow through on the objective it set out to accomplish when it asked the National Academy of Sciences to provide an unbiased evaluation of the existing QC sanction system. We urge discussion and debate of the Academy's recommendations for reform and for relief from the damaging effects of the current system.

We believe the time is right to make the needed changes, to achieve an equitable, more realistic AFDC performance measurement system, and a sanction policy which promotes public confidence that tax dollars are meeting agreed upon objectives.

I thank you again for this opportunity to share my thoughts with the committee.

[The statement of Leslie Frye follows:]

STATEMENT OF LESLIE FRYE, CHIEF, CALIFORNIA STATE DEPARTMENT OF SOCIAL SERVICES CORRECTIVE ACTION BUREAU

My name is Leslie Frye. I am Chief of the California State Department of Social Services Corrective Action Bureau. My responsibility is to assist California's 58 counties to reduce payment errors in the Aid to Families with Dependent Children (AFDC) and Food Stamp programs. I thank the Subcommittee for this opportunity to comment on AFDC quality control (QC) and fiscal sanction issues from California's point of view.

The AFDC quality control and sanction system currently operating is seriously flawed. This is not a point of controversy among members of Congress who commissioned the National Academy of Sciences to study the system and make recommendations for its improvement. The study is now complete, and we look forward to development and implementation of those recommendations which will result in a more accurate portrayal of States' performance in administering AFDC benefits and a more realistic approach to achieving program improvements.

We know that something is fundamentally wrong when more than 80 percent of AFDC jurisdictions are labelled as poor performers each year. The General Accounting Office and others have identified problems with using the current Federal rereview and regression methodologies for establishing midpoint error rate estimates for the purpose of computing States' sanction liabilities. Methods which are adequate for identifying error trends and likely error causes are simply too fraught with "guesstimation" and uncertainty to be utilized for reduction of resources critically needed for ongoing service delivery and improvement.

While we are not opposed to sanctions in cases of extreme, chronic poor performance coupled with demonstrated unwillingness to work toward improvement, the current Federal system does not operate under these constraints. The result is sanction liability for most States, which forces massive expenditures and direction of resources toward justifying past performance rather than correcting ongoing problems. Such defensive exercises have seriously detracted from a productive Federal-State relationship.

The National Academy of Sciences study recommendations will remedy most of the concerns of States; implementation will refocus the QC/sanction system on program improvement by:

- Recognizing legitimate differences in State to State caseload characteristics when evaluating States' performance;
- Measuring adherence to each State's own Federally approved plan for operating the AFDC program. Program policy differences would be resolved through the plan approval process, not through citation of errors in individual sample cases;
- Requiring use of the lower limit of the error rate point estimate for levying any fiscal sanctions - a figure which is virtually indisputable as a measure of actual performance; and
- Providing relief for States from penalties imposed under the current, highly controversial system, which has unreasonably labelled most States as poor performers.

We support these reforms because they address the failings of the current system, among which are that:

- It disregards State to State socioeconomic and program variations.
  - For example, differing rates of unemployment; size, mobility and variation of caseload; and sophistication of clientele have been shown to affect controllability of errors.
  - Also, the more program options a State enacts to serve its needy residents, the more complex and, thus, error prone the program becomes.
- It relies on unsound statistical sampling and analytical procedures to estimate error rates.
  - A single case in California, selected for Federal rereview, resulted in an additional $8 million in AFDC sanction liability.
  - Many experts have called into question the application of the Federal regression technique used to estimate error rates and thus actual program performance.
- It ignores cost-effectiveness factors in error reduction.
  - A recent study by the Department of Health and Human Services Office of Inspector General of error reduction efforts in the AFDC program found that "big bang" systemic changes made to address error causes have already been implemented by States and did result in significant improvements in AFDC performance nationwide. The remaining multitude of small corrective actions required to fine tune program management to achieve and maintain error rate targets are far more difficult to implement, and may exceed the cost of the errors they are designed to prevent.
- The current system fails to differentiate between client caused errors, over which States have limited control, and errors caused by the agencies administering the programs.
- The current quality control system provides error rate data far too late to be of use in corrective action planning.
  - Final error rates lag two or more years behind the review period. We need this information more quickly in order for it to be of use in identifying and resolving error causes.
- This system results in consideration of uncollected sanction liabilities as a source of funds for balancing the Federal budget.
  - We recognize that it is extremely difficult for Federal officials to look at potential AFDC sanction receipts as other than windfall available to fund current and future commitments. The hundreds of millions of dollars in sanction notices served to date in the AFDC program would appear to be a very opportune source of revenue.
  - Yet from States' perspective, these are funds already expended to administer programs in good faith, in some cases back to FFY 1981. The fact remains that we continue to need these resources to maintain service delivery to our needy residents.

- The sanction system imposes arbitrary performance standards on States, standards which simply do not reflect what is possible for most States to achieve, and which fail to acknowledge that policy choices to target specific populations necessarily result in complex and error prone regulations.

I began my public service career as an eligibility worker in Contra Costa County, California. Those years as an EW left me with a deep appreciation of the difficulties caseworkers face daily, dealing with families in need of food, clothing, shelter, and a great deal of support. An eligibility worker must apply hundreds of complex regulations to these real world situations, and do so quickly, fairly, and compassionately.

Despite these pressures, improving their accuracy rate, as we prefer to view it, is also an important responsibility of eligibility workers. There is not an EW in the State of California who is unaware of the importance of getting the right amount of money to the right people. In California we rely on the front line of eligibility workers for creative yet practical and effective solutions to error problems. They know the programs best and are in the best position to improve program operation at the point where errors occur.

It concerns me that the message we give EWs, despite the significant improvements in accuracy we and other States have made over the last ten years, is that they have failed. They - and all of us involved in administering welfare programs - have failed because we have not met the arbitrary performance standard of three percent.

A basic tenet of human behavior is that achievable goals challenge people while unrealistic goals frustrate and discourage them. We strongly urge that the performance standard for AFDC be established at a level which many States have achieved. A performance standard within our reach can help us to improve our accuracy rate. One that has been shown year after year to be impossible for most States to achieve or maintain serves no positive purpose.

The current AFDC quality control and sanction system is damaging to the program it purports to improve. There is very likely a public perception that our welfare programs are largely mismanaged - with more than four-fifths of AFDC jurisdictions each year judged against Federal performance standards and found lacking - and also very likely an erosion of public confidence in and support of these greatly needed programs.

California joins other States in urging Congress to follow through on the objective it set out to accomplish when it asked the National Academy of Sciences to provide an unbiased evaluation of the existing QC/sanction system. We urge discussion and debate of the Academy's recommendations for reform and for relief from the damaging effects of the current system. At a minimum, we seek extension of the moratorium on collection of sanctions levied under a system widely recognized as flawed, to allow more time to evaluate the recommendations.

We believe the time is right to make the needed changes to achieve an equitable, more realistic AFDC performance measurement system and a sanction policy which promotes public confidence that tax dollars are meeting agreed upon needs in our society.

I thank you again for this opportunity to share California's perspective with the Subcommittee, and I would be happy to answer any questions you may have.

Acting Chairman DOWNEY. Bob.

Mr. MATSUI. Thank you, Mr. Chairman. I would only like to thank the American Public Welfare Association and the two that testified today for their able testimony. I think it is going to be very helpful to us.

I do have one very brief question. In terms of Senator Evans' legislation, I take it that the APWA has reviewed it or at least seen it, and that is the direction from both of your testimony, that you would like to take any further quality control legislation. Is that my understanding?

Ms. FRYE. Yes.

Ms. BARRY. Yes.

Mr. MATSUI. I appreciated your testimony regarding what other things you could do with the money that would have to go back to the Federal Government in the event those sanctions are imposed, because I think that really underscores what we are talking about.

Barring the possibility that we can move a bill immediately, these sanctions will be imposed, and many of you are in the middle of your fiscal year. How would that disrupt or not disrupt your current programs? And very briefly, what would you have to do in that case, because I know in California the programs are in the middle of the fiscal year.

Ms. FRYE. Yes, it would be devastating in terms of administrative cost primarily and initially and in other kinds of services. In California, our benefit levels are set statutorily, which would mean that we would need to make up for the reductions in other programs and it would hurt our ability to maintain the programs at the quality that we have been able to achieve over the past.

Ms. BARRY. Quite honestly, in Ohio if I were faced with having to—and our Governor and legislature were faced, we would have severe cutbacks in staffing first, and then we would have to move on to looking at benefit levels. And I believe, Mr. Matsui, you mentioned earlier that what we would end up doing is harming programs more and in turn having higher error rates because we would have fewer staff people on the line who would be undertaking eligibility determinations. States just do not have this kind of money midbudget cycle.

Mr. MATSUI. Thank you very much.

Acting Chairman DOWNEY. I also want to thank the panel.

The committee will next hear from the Center on Social Welfare Policy and Law, Timothy J. Casey.

STATEMENT OF TIMOTHY J. CASEY, STAFF ATTORNEY, CENTER ON SOCIAL WELFARE POLICY AND LAW, ON BEHALF OF THE HOUSTON WELFARE RIGHTS ORGANIZATION AND THE MICHIGAN WELFARE RIGHTS ORGANIZATION

Mr. CASEY. I have a prepared statement that I would like to enter for the record.

Acting Chairman DOWNEY. Without objection, your statement will be inserted in the record.

Mr. CASEY. I very much appreciate the opportunity to appear here today to explain how current quality control policy has hurt the children AFDC is intended to benefit, and to express very strong support for the recommendations of the National Academy of Sciences to reform the current quality control system.

From the perspective of the children the program is intended to benefit, there are three major flaws in the current quality control system. The Academy has recommended reforms for all three.

The first flaw is that the system threatens to penalize the children the program is intended to benefit. It is not a State that pays a penalty, it is people in the State who pay a penalty. The States have repeatedly said that if the huge amounts of accrued QC liabilities that are outstanding are collected, they will reduce benefits to needy children. We think the Federal Government should take a different approach to error reduction.

At a minimum, Congress should adopt the recommendation of the Academy that only States that truly perform subnormally should be subject to sanction. Threatening all States with sanction is absurd.

Even better, what the Federal Government should do is to help States that are identified as performing poorly to find out why they are performing poorly and to improve their performance. Sanctions should be considered not based just upon a statistic, but if and only if a State whose performance is poor refuses to take reasonable steps to reduce error that the Federal Government tells it that it should take.

If sanctions are continued, we think it is imperative that Congress put in place a system to try to protect the children the program is intended to benefit from losing benefits as a result of a sanction. The Academy has made some recommendations in this area. There is no system that could provide 100-percent protection, but right now there is nothing that offers any protection.

The second major problem in the current system is that the fiscal sanctions policy has ignited a truly incredible growth in denials to eligible children. There are two reasons for this.

One reason is that the policy sanctions payment errors but not denial errors. Sanctioning payment errors but not denial errors causes denial errors. The States have only limited resources to devote to prevention. If they are sanctioned only for payment errors, then most of those resources will go toward trying to prevent payment errors and little will go toward trying to prevent denial errors.

So we support the recommendation by the Academy that if there is to be a sanction system, it must be an evenhanded system, one that no longer sanctions just payment errors but also sanctions denial errors.

The General Accounting Office has also recently recommended that Congress consider sanctioning denial errors after finding that the actual food stamp denial error rates were far higher than the States were reporting. In the report which is cited in my prepared statement, the General Accounting Office specifically recommended that Congress consider sanctions for erroneous denials.

The second way in which the current policy encourages denials to eligibles is by how it defines a sanctionable error. It is important to understand that merely adding sanctions for erroneous denials, in and of itself, will not eliminate the current incentive to deny benefits to eligibles. Crucial also is how a sanctionable error is defined.

Right now the system charges States with a sanctionable error for incorrect payments whose incorrectness could not be identified at the time the payment was made through the procedures available to the State. If there are to be sanctions for payment errors, it is imperative that States not be sanctioned for payments that were correct based upon the information available through approved verification procedures. Because if you tell States you are going to sanction them when quality control comes in 6 months later and says that if you had all the information we have now through the quality control investigation you would have known this person was ineligible, the States are going to pursue omniscience. And in benefit administration, if you pursue omniscience, you cannot achieve it but you move toward a verification extremism.

Since this sanction policy was initially adopted in AFDC in 1973, procedural denials—denials because a parent has allegedly failed to comply with program verification procedures—have grown enormously in AFDC. This is documented in the paper we submitted to the Academy which is cited in its report and reprinted in the transcript of the food stamp hearings last October on the Academy's food stamp recommendations. We estimated that between 1973 and 1985 there was more than a 1 million increase in the annual number of AFDC case denials. We also estimated that the entire increase was due to an increase in procedural denials—children being denied benefits because their parent has allegedly failed to comply with some verification requirement. We finally estimated that based upon the limited available evidence, probably something like two-thirds of the children who are denied benefits through these so-called procedural denials are eligible.

If our estimates are correct, half of all denials in AFDC are now denials where there is no determination that the children are ineligible but only a determination that the parent has not complied with a verification procedure. If two-thirds of these denials, as we believe, are denials to eligibles, this means that at least one-third of all denials are denials to eligibles. Since roughly 6 million children a year are denied AFDC benefits, that means at least 2 million children a year are being denied AFDC benefits to which they are eligible, largely as a result of incentives built into the current fiscal sanctions policy. We therefore support the Academy's recommendations for reform of that policy.

The third major problem is the QC system for reviewing benefit denials. In looking at that system, I am reminded of a remark by Mark Twain that there are three types of lies: lies, darned lies, and statistics. The QC denial review statistics are a darn lie.

HHS has reported to Congress and to the States that in 1984 roughly 1 out of every 100 denials in AFDC was an erroneous denial. Yet I am telling you that roughly at least 30 out of 100 denials were denials to eligibles.

Why do I say 30 out of 100 when they say one out of 100? There are two basic reasons. First, HHS and USDA have deliberately built a system with a bias toward understating the true denial error rate, as GAO has confirmed. They have omitted key safeguards which they mandate for QC payment review. That is, they have safeguards in payment review to try to assure that the data that you get is accurate, but they do not have those safeguards in denial review.

One of the key safeguards whose absence results in an understatement of denial error is a field investigation. In QC payment review QC workers are prohibited from determining that a payment was correct based solely on the information in the case record. Before they can say that a payment was correct, they have to conduct a field investigation in which they interview the claimant and make other contacts.

In QC denial review QC workers are told, in essence, to classify a denial as correct if based upon the information in the case record the denial appears to be correct without making any attempt to verify the accuracy of the information in the case record. Yet the departments require a field investigation for QC payment review because they know that information in the case record may be inaccurate.

GAO has detected specific instances in food stamps where the failure to conduct a field investigation led QC workers to classify as correct denials which would have been classified as erroneous if they had conducted a field investigation. We believe that it is critical that a field investigation be built into the QC denial review system.

The second major safeguard problem is the lack of Federal validation. In payment review the States do the initial review and then the Federal departments that validate their findings. If the States do not accurately measure payment errors, there is also a penalty built in through Federal validation by which the payment error is inflated if the Federal departments find errors which the States did not find.

There is no validation system in denial review. When GAO looked sometime last year—its report was issued last October—at the food stamp denial error rates the States were reporting, it found that the actual rates were far higher. It recommended that hereafter USDA should validate the State reported rates. We believe the Federal Government should do this if it keeps a two-tier system.

The second major problem with QC denial review goes to the question of what it measures. It can be true at one and the same time that half of all denials are denials to eligibles and that there is a zero error rate. QC measures only erroneous denials, defined as those that are not correct for the reason given. QC review should also measure denials to eligibles whether or not erroneous.

Let me give you a concrete example. A mother applies for benefits for her children. She does not submit some document that the State asks her to submit for whatever reason and the application is denied. When QC looks at the denial the only question it will ask is, did the mother submit the document. If she did not submit the document, QC will classify the denial as correct, and will not make any determination whether the children were eligible.

Right now you have a program where roughly half of all denials are procedural denials which can be correct even though they are denials to eligibles The QC system does not now try to measure how many of this sort of denials are denials to eligible children. It should. We do not recommend that States be sanctioned for such denials, but we want to see them measured.

Thank you.

[The statement of Timothy J. Casey follows:]

STATEMENT OF TIMOTHY J. CASEY, ON BEHALF OF THE HOUSTON WELFARE RIGHTS ORGANIZATION AND THE MICHIGAN WELFARE RIGHTS ORGANIZATION

We appreciate the opportunity to explain how current Quality Control (QC) policy has hurt millions of needy children AFDC is supposed to help and to express support for the reforms recommended by the National Academy of Sciences in its report From Quality Control To Quality Improvement In AFDC and Medicaid. After a thorough study the Academy has reported to Congress that "quality control, as currently implemented, is a misnomer" which does not promote AFDC's objectives. We hope that Congress will pay heed.

From the perspective of the needy children AFDC is intended to help there are three fundamental flaws in current QC policy. The Academy has recommended reforms to address each.

The three fundamental flaws are as follows. First, the fiscal sanctions policy threatens reductions in already inadequate AFDC benefits. Second, the fiscal sanctions policy has ignited an explosive growth in denials to eligible children. Third, the QC denial review statistics vastly understate denials to eligible children which now are probably well over two million a year.

POINT I

Reducing federal AFDC funds is an inappropriate response to errors by state AFDC workers and threatens cuts in already inadequate benefits. If a fiscal sanctions policy is continued, as recommended by the National Academy of Sciences:

- **only states whose performance is subnormal should face sanctions;**
- **protections are needed to minimize the risk that children's benefits will be reduced.**

The QC fiscal sanctions policy reduces federal AFDC funds when state workers supposedly fail to correctly apply state policy in a supposedly excessive number of cases. States have said that benefits to children will be reduced if the QC penalties that have accrued are collected. Current federal law would allow this and there is every reason to believe them.

Unless one believes that state AFDC administrators do not want their workers to follow state AFDC policy, it is hard to see a case for a policy that threatens such grave harm to the needy children AFDC is supposed to help. Rather than in effect penalizing the children AFDC is intended to help for errors by state workers, the federal government should take a different approach.

At a minimum the sanctions policy should be revised as recommended by the Academy so that only states whose performance is subnormal are potentially subject to sanction. Even better, the federal government should concentrate on assisting poorly performing states to find out why they are performing poorly and consider sanctions if and only if a state refuses to implement reasonable error reduction policies recommended by federal officials. If sanctions are ever imposed, it is crucial, as the Academy recommends, that Congress take steps to minimize the risk that children will lose benefits as a result.

POINT II

The current QC fiscal sanctions policy encourages denials to eligible children 1) by sanctioning erroneous payments but not erroneous denials and 2) by sanctioning incorrect payments that could not be avoided under federally approved verification procedures. If a sanctions policy is continued, as recommended by the National Academy of Sciences:

- **there should be sanctions for erroneous denials (and underpayments) as well as for erroneous payments to ineligibles (and overpayments);**
- **incorrect payments that could not be avoided under federally approved verification procedures should no longer be considered sanctionable errors.**

The Academy has recommended sanctions for excessive erroneous denials (and underpayments) if there continue to be sanctions for excessive erroneous payments. This recommendation rests on unchallenged evidence that sanctioning only payment errors causes denial errors. The imbalance in the sanctions policy encourages state AFDC administrators to allocate a disproportionately large share of finite error prevention resources to payment error prevention and a disproportionately small share to denial error prevention. It also encourages state AFDC workers always to interpret policies and to exercise judgment restrictively.

The Academy's report repeatedly cites our analysis concluding that the current sanctions policy has caused an explosive increase in denials to eligibles. This conclusion is supported by empirical studies cited by the Academy in states as diverse as Colorado, Michigan, Massachusetts, and New York and by program application, denial, and participation rate statistics.

To give one example, the study by the New York State AFDC agency cited by the Academy reported that 30% of the AFDC denials in the study sample were erroneous. The State attributed this shocking error rate to lack of due care in the administration of the payment error prevention procedures that had been adopted in response to the current sanctions policy. The State report also cited the work of urban anthropologist Dr. Anna Lou Dehavenon. She has documented hundreds of specific instances in which denials to eligible children spurred by the current sanctions policy have caused grave food emergencies. She has also documented specific instances in which such denials have made children homeless.

The General Accounting Office (GAO) has also recently recommended consideration of sanctions for excessive erroneous denials after finding denial error rates that were far higher than the officially reported rates. Food Stamp Program: Evaluation of Improper Denial or Termination Rates, GAO/RCED-88-12 at 14 (October 22, 1987). GAO re-reviewed Food Stamp denials previously reviewed by state QC workers in Illinois and Maryland. It found that in Illinois the actual denial error rate (22.5%) was two and a half times the state-reported rate (9.1%) and that in Maryland the actual error rate (12.4%) was more than 5 times the state-reported rate

(2.2%). USDA and state officials agreed with these findings (p. 5). In response to the GAO findings, USDA re-reviewed denials in 21 states and "uncovered the same types of problems" (p. 15). USDA found that the true error rates "ranged from 23.21 to 0.12 percent whereas the state-reported rates ranged from 6.94 percent to 0.0 percent" (p. 15).

According to GAO, both state and federal officials attributed the denial error problems to the current policy of sanctioning only payment errors (p. 26). GAO recommended that the federal agency "examine alternatives to encourage states to reduce improper denials and terminations, including seeking authority to hold states financially liable for their improper denials and terminations" (p.28).

The Academy has also recommended that incorrect payments that were unavoidable under federally approved verification procedures no longer be considered sanctionable errors. This recommendation would limit sanctionable errors to incorrect payments due to worker failure to follow approved state policy. This is essential to protect the children AFDC is intended to help.

By law and of necessity states must issue AFDC benefits to children who satisfy program eligibility requirements based on the information available through approved verification procedures. Otherwise AFDC would simply cease to function.

It is inevitable that the information available through approved verification procedures will sometimes be inaccurate. It defies common sense and basic fairness to sanction states for this. The federal government should hold states liable only if state workers do not follow the verification procedures that have been mandated and approved.

Sanctioning states for "unavoidable" payment errors has resulted in a verification extremism that has had disastrous consequences for the children AFDC is intended to help. Driven by the fear of sanctions states have adopted ever more extreme verification requirements. Ever increasing numbers of parents are unable to satisfy them, sometimes because it is literally impossible to do so, sometimes because they need more time than is given, and sometimes because they need help that is not given. The result has been a huge growth in denials to children because of parental failure to satisfy verification requirements. A major portion of these so-called "procedural denials" are denials to eligibles.

From 1972, the year prior to the adoption of a QC sanctions policy, to 1985, the most recent year for which the data is available, the annual number of AFDC application rejections and case closings increased by more than one million. In our analysis on "churning" that the Academy repeatedly cited, Quality Control and the "Churning" Crisis, we concluded that the entire increase was due to an increase in procedural denials. ("Churning" is a commonly used catchword for procedural denials.) We estimated and the Academy reported that half of all AFDC denials are now procedural denials.

Based upon program statistics, 16 studies by state agencies and others, and our survey of state AFDC commissioners, we also estimated that at least 65% of procedural denials are denials to eligible children and that over 2 million eligible children a year are now denied AFDC through procedural denials. Our analysis is reprinted in the transcript of the October 22, 1987 joint hearing on Quality Control and Fiscal Sanctions in the Food Stamp program before subcommitees of the House and Senate Agriculture Committees at which we testified at the Committees' request. A copy is being provided to the Subcommittee for its use.

POINT III

Current QC denial review policy conceals that millions of eligible children are denied benefits 1) by understating the true rate of erroneous denials and 2) by not measuring denials to eligibles from the correct application of state verification policies. As recommended by the National Academy of Sciences reforms in QC denial review are essential to reveal the true extent of denials to eligibles.:

- **the Department of Health and Human Services should be required to establish safeguards that will assure that the reported QC denial error rate ceases to understate the true denial error rate;**
- **QC denial review should measure denials to eligible children from the correct application of state verification policies.**

There is every reason to believe that in AFDC the reported QC denial error rates are below the true rates as GAO found them to be in Food Stamps. In both AFDC and Food Stamps the federal departments have built in a bias toward understating the true denial error rate by omitting key safeguards that they require for QC payment review. The two most serious flaws are 1) the limitation to a case record review and 2) the lack of federal validation of state findings.

Except in unusual cases a QC denial review is simply a case record review. QC reviewers are instructed to classify a denial as correct if the case record information supports it without verifying that the information in the case record is accurate. By contrast, QC reviewers are prohibited from classifying a payment as correct unless they have verified that the case record information is accurate through a field investigation and claimant interview.

The federal departments require a field investigation in QC payment review precisely because case record information may be inaccurate. A field investigation should be required in QC denial review for the same reason. The Academy found that because now there is only a case record review, reported denial error rates "may substantially understate" true rates and concluded that "clearly, new strategies will have to be developed that accurately measure the rate of erroneous denials". GAO documented specific instances in which GAO field investigations detected erroneous denials that had been classified as correct based on a case record review.

The federal departments' failure to routinely validate state reported denial error findings despite their routine validation of state reported payment error findings sends an obvious signal. No wonder that the Academy found "that in .. site visits to local, state, and regional offices around the country, it was reported that state QC reviews do not examine negative actions as intensively as they do the active caseload..".

GAO identified the lack of federal validation as a main culprit for understated denial error rates and recommended routine federal validation of state denial review findings through the same process used to validate state payment error findings. This is essential if Congress rejects the Academy's recommendation that responsibility for QC reviews be shifted from the states to the federal departments.

HHS will not cure these and other flaws in QC denial review unless Congress tells HHS that it must have safeguards adequate to assure that reported denial error rates are valid. HHS has a longstanding record of indifference to the adequate measurement of denial errors. Indeed, when it originated the one-sided fiscal sanctions policy by administrative fiat in 1973, HHS simultaneously eliminated QC denial review, restoring it only after welfare rights organizations sued to have it restored.

In addition to requiring safeguards to assure the validity of reported denial error rates, Congress must also require that QC measure denials to eligibles from the correct application of state verification policies in order to reveal the full extent of denials to eligibles. Information on correct denials to eligibles from agency verification procedures is indispensable to rational administration. It could be efficiently and effectively obtained through the QC denial review system and is not available from other sources.

Although millions of children a year are denied AFDC because of alleged parental failure to comply with a state verification procedure, HHS and the states do not know nor seek to know how many of these procedural denials are denials to eligibles. This is shocking. Procedural denials probably account for half or more of all denials. There is evidence that as many as two thirds or more of procedural denials may be denials to eligibles. Many of these could easily be avoided by low or even no cost changes in state verification procedures. At least some would be avoided if AFDC administrators were routinely confronted with the full consequences of extreme verification requirements.

There is a widespread misconception that QC denial review measures denials to eligbles. But QC denial review now measures only denials from the incorrect application of agency policies. Denials to eligibles may also result from the correct application of agency verification policies. It is imperative that these "non-erroneous" denials to eligibles be measured.

Broadening QC denial review to measure denials to eligibles despite correct application of agency policy is consistent with the broad nature of QC payment review. QC payment review measures both payments to ineligbles from the incorrect application of agency policy and payments to ineligibles despite correct application of agency policy. It uses a full field investigation including a claimant interview to do so, and this same approach could be used in denial review. Experience and the Academy's observations teach that without a requirement to measure procedural denials to eligibles, the states will not do so.

Acting Chairman **Downey**. That is a very interesting point about those who might be eligible but not receiving benefits. It further indicates to me that the whole process is geared not toward taking children out of poverty but toward reducing the cost of the system.

Mr. **Casey**. You have to remember that when HHS first established a sanction system back in 1973, it entirely eliminated, secretly, QC denial review. Representing welfare rights groups, we sued HHS, I believe in 1975. And as a result of the lawsuit, HHS did reinstate denial review to put in the procedures needed to measure the true extent of denials to eligibles.

So while with one hand, through the fiscal sanctions policy, QC encourages denials to eligibles, with the other hand it conceals what is really going on by giving you what is really phony data on the rate of denials to eligibles.

Acting Chairman **Downey**. Thank you for your testimony.

The subcommittee stands adjourned.

[Whereupon, at 1:05 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Written Testimony of Charles M. Atkins
Massachusetts Commissioner of Public Welfare
Submitted to the House Subcommittee
on Public Assistance and Unemployment Compensation

Hearing on the AFDC Quality Control System
April 13, 1988

My name is Charles Atkins. As Commissioner of the Massachusetts Department of Public Welfare for the past five years, I have been strongly committed to improving the quality of public assistance programs. Like many of my fellow human service administrators however, I do not believe that the current system of federal Quality Control (QC) sanctions has served this purpose well. Therefore, I would like to share with you our concerns and suggestions for reform.

Congress recognized the flaws inherent in the QC system by mandating studies by the National Academy of Sciences (NAS) and the Department of Health and Human Services (HHS). Now that these studies have been completed and submitted to Congress, we hope that Congress will continue to work toward correcting the deficiencies in the current QC process.

Again, let me emphasize that state welfare administrators are committed to the concept of quality control. In Massachusetts, an integrated, long-term strategy for error reduction has resulted in a decrease in our AFDC error rate from nearly 12% in 1983 to its present level of 3%. We have also succeeded in reducing the Medicaid error rate from over 8% to 1%. And in the Food Stamp program, our error rate has declined from almost 14% in 1983 to 5%.

Massachusetts and other states have achieved such dramatic results by committing resources and top management's efforts to error reduction. In my opinion, states' progress is not due to the threat of sanctions or harassment by the federal government. Since states pay a large share of the cost of welfare programs, we have as much at stake, if not more than the federal government, in the quality control process. We do not need sanctions from the federal government to prod us to better performance.

The Current QC System Relies on Only One Measure of Performance

Among the major flaws in the current QC system is the fact that it focuses exclusively on payment accuracy, which is only one indicator of quality in programs. At the same time, it fails to recognize other critical agency outputs and goals such as job placements, child support enforcement collections and timely action on applications. By ignoring these important measures of performance, our QC system diverts managers' efforts from real results to a meaningless numbers game. And as a result, QC in public assistance programs has become one of the most formidable obstacles to good management and efforts to move America's poor into self-sufficiency.

The Current QC System Does Not Function as an Effective Management Tool

Although QC started out as a management tool, which helped federal and state administrators monitor the accuracy of payments to clients, it has quickly evolved into a means to audit and penalize states. By imposing enormous fiscal sanctions -- over $2 billion from states in penalties for payment errors through 1988 -- the current system is not helping managers do their jobs. It is only making it more difficult.

Moreover, if the federal government succeeds in collecting these sanctions from the states, it will, I believe, have a serious negative effect. States will be forced to use their financial resources to pay sanctions, rather than to pay for the staff or the training and computer equipment needed to reduce the error rate.

There are a number of ways in which the QC system as we know it discourages effective management. The current system:

- acts to divert limited state resources from real error reduction efforts and other initiatives to pay for enormous sanctions;
- distorts management decisions and discourages innovation, out of fear that such change might produce costly errors;
- creates discentives for collecting useful management information and identifying errors;
- forces the federal government and states into a drawn out debate over the sampling techniques and regression formulas used in error rate measurement;
- fails to produce the information states need to improve their decisions on eligibility, payment amounts, or corrective actions;
- ignores cost effectiveness; and
- misses entirely what should be the key output measures of the public assistance system, such as job placements and child support enforcement.

In combination, these factors produce a QC system which impedes effective management of the very same programs it is intended to serve.

The Current Error Rate System Contains Major Flaws in Accuracy as a Sanctioning Tool

The current QC system contains a number of deficiencies as a tool for error measurement. This system:

- fails to distinguish between agency and client errors and recognize that states are far more limited in their ability to control client errors;
- confounds error rate measurement in AFDC by including technical or procedural errors that do not include overpayments;
- fails to address the problems with the statistical procedures within the QC system such as the use of the mid-point of confidence interval to determine error rates and fiscal sanctions; and
- uses error rate tolerance levels which do not reflect the relevant demographic and program differences from state to state and hold states to higher standards than are expected of many other government programs.

National Research Council Findings

State human service administrators were eager to learn about the findings of the NAS and HHS studies. Given the lack of responsiveness on the part of HHS to states' concerns about QC, it came as no surprise that the HHS study found the principles and methods of the current QC systems to be "valid and effective." States' efforts to reduce error and improve program management have been repeatedly thwarted by HHS' unwillingness to recognize the problems in the present system. Since the HHS report offers little substance regarding how the current system might be improved, we find it more useful to turn our attention to the findings of the NAS study.

The NAS study appropriately concludes that the current QC system do not help improve program management or program effectiveness. In spite of any benefits associated with the current system, the panel quickly recognized that it is not working very well. We agree with the panel's view that comprehensive change is needed to correct the problems that now exist with QC and to build a system which provides states with the necessary tools to measure and maintain performance. Therefore, we support the panel's recommendation that a new system be developed, which separates program improvement efforts from the function of monitoring payment accuracy.

Since QC should support management improvement efforts which are ultimately intended to serve program objectives, we believe that the NAS study is correct in its assertion that measures of quality should reflect not only some, but all dimensions of program performance, particularly if financial consequences are attached. Payment accuracy is only one of many such indicators. We agree with the report's recommendation that broader and more reliable measures of program quality should be developed and used to promote quality control and quality improvement in programs.

The NAS report makes several other important recommendations. The new system they propose would:

- recognize the variation from state to state in demographics and programs and evaluate each state's performance based on their individual state plans;

- work with states by identifying and distinguishing common problems and helping them to correct them;

- recognize the importance of rewards, as well as sanctions, as an incentive to change performance;

- calculate penalties and rewards as a proportion of benefit dollars, using established performance standards and incorporating state-to-state differences; and

- monitor sanctions and where necessary, provide technical assistance to ensure that state programs do not suffer.

Overall, we believe that the changes proposed by the NAS report would correct many of the deficiencies in the current system and would make the QC system a more effective tool for program improvement.

Legislative Efforts to Reform QC

We wholeheartedly endorse the recent effort in Congress to enact reform of the QC system. States are also looking forward to the proposal for QC reform to be introduced in the House by Representative Matsui. In the Senate, we are also awaiting a proposal by Senator Evans that will seek to achieve the goal of QC reform.

In spite of the lack of cooperation from HHS, state human service administrators are eager to work closely with Congress to design and implement a more effective QC system. We are committed to assisting Congress in any way we can to bring about this important reform.

What is now before Congress is an opportunity to work with states to shape a more effective and equitable quality control system. It is my hope that you will act quickly upon this opportunity.

STATEMENT OF CESAR PERALES, COMMISSIONER, NEW YORK STATE DEPARTMENT OF SOCIAL SERVICES

I am most pleased to submit a statement for inclusion in the record of the Subcommittee on Public Assistance and Unemployment Compensation's hearing on Recent Studies of the AFDC Quality Control System and the Need for Reform.

The issue of quality control and error rates is one of the paramount concerns at any state welfare agency. In the five years that I have served as Commissioner of the New York State Department of Social Services, the concern for quality as measured by the error rate has been integral to administering the AFDC program. As public servants we have an obligation to run our programs as efficiently and effectively as possible. Having a mechanism in place to give a regular reading on quality is important and a powerful management tool to improve program administration. Unfortunately, federal agencies have not used the Quality Control System as I believe Congress intended and as I, a state welfare director, would like.

While I gladly welcome the accountability a quality control system establishes, the system must be fair and comprehensive to achieve its intended goals. The current system is neither. The Administration is, unfortunately, bent on using this system to perpetuate the notion that welfare programs are terribly mismanaged and that welfare rolls are full of cheats and swindlers. As a result, the Administration believes that the only way the Federal government can address these problems is through leveling massive fiscal penalties on the states.

It is difficult, particularly in times of $200 billion federal deficits, for state welfare directors to argue against sanctions and refute the myths on the administration of these programs and the integrity and veracity of the persons the programs are charged to serve. I believe it is very clear to those who have examined this issue, however, that the Administration views QC sanctions as a politically acceptable method of reducing federal support to welfare programs. I am heartened that the Congress questioned this notion by enacting a moratorium on collecting sanctions and requiring a thorough study by the National Academy of Sciences (NAS). The NAS study is a well reasoned analysis of what is wrong and what is right with the current QC system and most importantly provides a detailed blueprint for reform.

Before addressing some of the inadequacies in the current system and specific reform recommendations, I think it is important to address some of the myths. It is important that Congress and the American people understand that welfare programs are among the best managed government programs.

The record over the past several years disputes the image of waste painted by the federal agencies. Error rates in the AFDC program have continued to decline from 7.7% in 1981 to 6.25% in 1985. Although the arbitrary 3% target has not been reached, the reduction does reflect significant progress from the 15% plus rates common in the 1970's. Moreover, this reduction has been achieved despite numerous and frequent changes in federal policy which make accurate eligibility determinations more difficult.

It is also important to note that the AFDC error rates, as published by HHS, reflect more than misspent dollars. Included are technical errors, such as absence of a social security number for an infant, disputes over program policy issues and disagreements over QC procedures. The actual percent of funds misspent is therefore considerably less than the HHS published 1985 rate of 6.25%.

While the error data published by HHS inflates misspending it does not include an assessment of underpayments or inappropriate case closings and denials. The QC system tabulates this data, but HHS expresses little, if any, interest in the results. Hypothetically, a state could inappropriately deny one of every two applications for AFDC, have an underpayment error rate of 10% and not be subject to any fiscal sanctions. I am very concerned with the message this gives to eligibility workers, line supervisors and managers. If there is any doubt - deny the application, reduce the grant. The bottom line message is that the client's needs are not as important as avoiding overpayments.

An interesting comparison can be made when the payment accuracy rates in the state administered AFDC, Food Stamp and Medicaid programs are contrasted with federally administered programs. NAS indicates that the error rate in the SSI program for which the federal government determines eligibility is only a little lower than the AFDC rate. The SSI population is much more stable and therefore less subject to change than the AFDC population. In addition, earned income, which is a key cause of error in the AFDC program, is not a factor with the SSI population. A more comparable population is Medicaid which has a lower error rate than SSI. I believe it is also relevant to consider that HHS has eliminated regulations which held them accountable for errors in the SSI program. Payment errors in this federally administered program result in misspending of state dollars in jurisdictions where a state supplement is provided.

Errors in the AFDC program should also be compared with the IRS. The NAS indicates that the error rate for tax collection is much higher. For 1986 the IRS estimates that the tax gap -- the difference between revenues collected and all that should be collected -- is $103 billion. This translates to a non-compliance or error rate of 18.5%. In addition, a recently completed GAO study indicated that the Internal Revenue Service gave incorrect answers to 39% of the questions posed by people who call for help with their tax returns. The Internal Revenue Service disputed these findings and said their error rate is only 25%.

GAO also looked at the Veterans Administration and found that 549,000 pensioners out of 1.4 million receiving pensions in 1984 failed to tell the agency about $947 million in income. It is estimated that overpayments totaled $182.5 million. I cite this information not to castigate veterans or the Veterans Administration, but rather to illustrate that Congress needs to consider federal agency performance in similar programs in establishing fair standards for states.

My arguments with the current QC system are not limited to the manner in which the rate is determined, the inclusion of technical errors, and the establishment of an arbitrary tolerance level. These points are important and reform is essential if quality control findings are to be used to assess penalties for mistakes in eligibility determinations. My argument is broader. If States are to be penalized (or rewarded) for administration of the AFDC program, it should not be based solely on payment accuracy, base it also on the underlying purposes of AFDC. For example,

- Hold States accountable for moving people to independence through employment training and educational programs.
- Hold States accountable for preventing AFDC dependency by ensuring that child support payments are made to the custodial parent.

The current system, in not recognizing those underlying objectives, is narrowly focused toward payment accuracy and does a disservice to state/federal efforts in human services.

The National Academy rightfully calls for a complete overhaul of the QC process. The concept of quality improvement, as spelled out in the NAS study, has tremendous potential for improving welfare programs. It can serve as a critical component of welfare reform allowing the states, the Federal government and the Congress with ongoing assessments of various program components. In New York, we have just completed a pilot project using QC reviewers to conduct client interviews to more adequately address the underlying causes of welfare. While we are still analyzing the data gathered, the initial results show this effort to be a most successful tool to improve our programs. While we want to do additional surveys, such efforts are resource intensive. The National Academy's recommendation to implement a Quality Improvement Program would permit us to mount additional efforts.

NAS recommends that the federally approved state plans constitute the criteria against which states are evaluated. This is especially critical since the federal agencies are using the QC process to cite policy disagreements. This is a particularly disturbing trend which has inflated New York's error rate significantly over the past three years.

Traditionally the federal QC process reviewed cases based on state policy. However, beginning in 1984 HHS began mounting an intensive challenge of long-standing state policies through the QC process. Two specific policies currently under attack are:

No Children with Cash Needs on the Case - New York State maintains the position that AFDC payments should be made in cases where the child has sufficient income to meet his own needs, but the household consisting of the parent and child is financially eligible. Generally, the child(ren) is in receipt of Social Security Survivor benefits (SSA) or Supplemental Security Income (SSI). Section 406(a) of the Social Security Act defines a dependent child as "a needy child 1) who has been deprived of parental support or care by reason of ...". In the current controversy the issue revolves around the interpretation of a "needy child". HHS maintains that "need" means financial need of the child only. Thus, HHS concludes that where the child has no financial need, he or she is not a dependent child. An AFDC case cannot, therefore, be based on the the child's ~~financial~~ dependency. As such, the parent(s) of the child cannot receive AFDC. It should be noted that under the federal interpretation, a family with a child in receipt of SSI is eligible for AFDC since SSI earnings are disregarded under section 402(a)(24) of the Social Security Act.

It is New York State policy that a child cannot be separated from the family for purposes of determining need. The financial resources of the family to acquire adequate food, clothing, and other material needs of family members are directly related to the needs of the child. Currently, section 402(a)(38) of the Social Security Act requires the inclusion of any parent of a dependent child in the filing unit. In addition, section 402(a)(7) of the Social Security Act requires the state agency, when determining the need of an AFDC applicant/recipient, to take into consideration any other income and resources of any child or relative claiming AFDC, or of any other individiual living in the same home as such child and relative whose needs the state determines should be considered in determining the need of the child or relative claiming such aid. State regulations support a finding that a child who has sufficient financial income to meet the expenses of his own maintenance shall be considered categorically eligible for AFDC if the parent with whom he is living and who is essential to his needs has insufficient means of self-support.

While our regulation has not changed, once the feds saw the potential for recovering "misspending", they began citing these cases as errors. They, of course, refused to use the compliance process which is specifically designed to resolve policy disputes.

The main argument in this regard is that the AFDC eligibility of a child receiving SSA cannot be considered separately from that of his/her parent(s). The current filing unit provisions require the parent to be included in the household in making an AFDC eligibility determination. This further supports our position that the child cannot be considered separately. It should be noted that prior to the filing unit provisions an applicant could choose who to include or exclude within the household. A child's needs would not be considered separately unless the applicant elected to exclude everyone else.

Disregard of Cash Contributions to the AFDC Unit - New York State also maintains the defensibility of the policy of disregarding cash contributions to AFDC recipients for specified items above the basic needs of the family. The federal agency does not agree. The cases in this category involve contributions by relatives which are used by the recipient to supplement rent that exceeds the shelter maximum. HHS maintains that such contributions are allowable only if they are made directly to the landlord. HHS treats such contributions as income if they are given directly to the recipient.

Although federal statutes and regulations are silent on the subject of contributions to recipients, HHS maintains that section 402(a)(7) of the Social Security Act includes cash contributions to recipients as income when it requires the state agency to take into consideration "any other income".
Therefore, there appears to be a conflict between a regulation incorporated into the state's approved state plan and the federal interpretation of our state plan. Accordingly, the dispute should be resolved through the state plan compliance process. Certainly, prior to such resolution, cash contribution should not provide a basis for QC error.

The above stated arguments are illustrative of but two policy disputes upon which the federal agency relies in making error pronouncements. The effect of the existence of several policy disputes in forming a basis for federal QC error findings is to artificially inflate the state's error rate. Thus, it is the cumulative effect of this practice over time which may result in having considerable fiscal sanctions imposed against the State of New York.

These two policy issues alone increased New York's potential sanction for 1986 by nearly $20 million. When the 1986 error rates are finalized by the Family Support Administration, Wayne Stanton will send a scathing letter to my boss, Governor Cuomo, that castigates New York State for errors. A good portion of those errors, however, will relate to policy disagreements for which Mr. Stanton chooses not to use the established state plan compliance procedures.

NAS also argues that technical errors should not be included in the sanctions. Currently, errors which do not affect a client's financial eligibility or the amount of benefits are included in the AFDC error rate. The two chief technical errors are the lack of a Social Security number and failure to register a client for employment service. Most of the Social Security number errors involve newborns. In addition, New York has eliminated most of its work registration errors by changing procedures to include on the application a notation that the client is registered for employment. The actual referrals and enrollment (previously called registration) for employment services occur as before. This federally approved procedural change's sole purpose was to eliminate QC errors. Through this change we are "saving" nearly $10 million a year. It should also be noted that unlike AFDC, technical errors are not counted in the Medicaid or Food Stamp programs.

NAS also questions many of the statistical methodologies utilized by quality control. Since the selection of the sample size and choice of the use of the point estimate is made by HHS, the Federal government should bear the burden of sampling error. When the lower bound of the confidence interval is not utilized, the range of sampling error can cause states to be overpenalized. Use of the lower bound to calculate fiscal sanctions is a commonly accepted standard used by states in auditing Medicaid providers. GAO also assesses penalties in the same fashion. NAS recommended in two separate reports (1982 and 1987) that the mid-point not be used so that states would be treated fairly.

Lastly, the issue of the treatment of past sanctions must be addressed. The equitable methodology suggested by NAS is an excellent start. Only states that are the extreme poor performers should be sanctioned. This could be achieved by implementing some of the NAS recommendations, most notably: the use of the lower bound, elimination of technical errors and assessment of error in accordance with the state plan would provide an objective comparison that could be historically applied.

I appreciate the opportunity to present this statement.

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